

13

OVERSIGHT OF U.S. CUSTOMS SERVICE AND TEXTILE TRANSSHIPMENT

4. G 74/7: C 96/3

ersight of U.S. Customs Service a...

HEARING

BEFORE THE

COMMERCE, CONSUMER, AND MONETARY AFFAIRS SUBCOMMITTEE

OF THE

COMMITTEE ON

GOVERNMENT OPERATIONS

HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRD CONGRESS

FIRST SESSION

OCTOBER 5, 1993

Printed for the use of the Committee on Government Operations



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OVERSIGHT OF U.S. CUSTOMS SERVICE AND TEXTILE TRANSSHIPMENT

TUESDAY, OCTOBER 5, 1993

HOUSE OF REPRESENTATIVES,
COMMERCE, CONSUMER, AND
MONETARY AFFAIRS SUBCOMMITTEE
OF THE COMMITTEE ON GOVERNMENT OPERATIONS,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:11 a.m., in room 2247, Rayburn House Office Building, Hon. John M. Spratt, Jr. (chairman of the subcommittee) presiding.

Present: Representatives John M. Spratt, Jr., and Gene Green.
Also present: Representative Stephen Horn.

Staff present: Thomas S. Kahn, chief counsel; Faye Ballard, clerk; Marc M. Rose, minority professional staff, Committee on Government Operations; and Martin S. Morris, GAO detailee.

OPENING STATEMENT OF CHAIRMAN SPRATT

Mr. SPRATT. Let me first apologize for being late. I had a telephone call I had to take just as I was leaving the office, and let me next welcome everyone to our hearing this morning.

This is an oversight hearing to examine two related topics, the operations of the Customs Service and its financial controls and the problem of textile and apparel transshipment and quota evasion. The Customs Service is the second largest revenue-raiser for the Federal Government. A distant second to the Internal Revenue Service, but nevertheless it generates over \$20 billion a year in revenues for the government.

In addition to collecting tariffs, Customs is charged with what seems like an increasing agenda of new responsibilities, protecting our borders, interdicting drugs before they cross our borders, monitoring for money laundering and the movement of high-tech products and weapons that are not export licensed, and, of course, watching out for smuggling and fraudulent trade.

Customs is one of the pilot agencies for the preparation of financial statements under the so-called Chief Financial Officers Act of 1990, a very fundamental and landmark piece of legislation. The General Accounting Office, in a report as of June 30, 1993, has examined the financial statements of the Customs Service and found serious problems across the board, it seems, with Customs control over virtually all of its activities.

In fact, the GAO report states that it is, "unable to express an opinion on the reliability of fiscal year 1992 Principal Statements of Customs because of the lack of reliable financial information, in-

adequate financial systems and processes, and its ineffective internal controls."

If Customs were a publicly held firm, and its outside auditor refused to certify financial statements, bells and whistles of all sorts would go off. Creditors would declare an event of default. The stock would plummet and probably be delisted. But this report from the General Accounting Office was sent to the Commissioner of Customs, the Secretary of Treasury, and half a dozen committees of Congress with little general alarm. And so my question to GAO, and then to Customs today is, are these deficiencies significant, or is this just an accountant's dispute? And if they are significant, to what extent are they being corrected, when, and how?

Of particular interest to us is GAO's caveat that Customs maintains, "no significant internal controls to ensure that merchandise entering the United States was identified and the proper duty assessed. . . . To the extent that Customs information may be in error according to GAO, our trade statistics could also be misstated. . . . It will take a significant effort to adequately address the broad scope of problems in this area," according to the General Accounting Office.

Today we want to obtain more detail from the GAO about its audit report on Customs, but in particular we want to understand the implications, the impact on U.S. trade policy, and the policing of imports and exports. And also we want to hear, of course, the Customs Service by giving them an audience and an opportunity to respond to GAO's criticism.

Our hearing today also is focused on transshipment. Transshipment literally occurs when goods are shipped from one country through another country and the transit country is falsely claimed as the country of origin. The term also applies when the goods never touch the soil of the country of origin or the country of transit, but are falsely declared on import documents or bills of lading to have originated in one place or another.

Transshipment broadly considered is a device to get around and circumvent quota restrictions and other trade requirements, especially the quotas that apply under the multifiber arrangement and our 40-odd bilateral agreements to textiles and apparel import. These goods represent over 33½ million articles. It has been estimated that as much as \$4 billion worth of textile and apparel imports are illegally transported into the United States every year.

These transshipments, according to some estimates, if we reckon the job loss or job displacement at 20,000 to 25,000 jobs per \$1 billion of imports, could be displacing as many as 100,000 jobs in the United States. China alone is by some estimates responsible for as much as \$2 billion, some estimates even go higher. Last July, Chinatex America, Inc., an entity owned by the Government of China, and its United States-based sales manager were convicted of fraud and criminal conspiracy in the district court for the Southern District of New York.

Here is how Customs itself or Treasury, I believe, Peter Nunez—Nunez is the Assistant Secretary of Treasury—described the findings of this Q-TIP investigation in a speech he made a year ago. Pretty astounding speech. He said:

Much evidence was uncovered indicating that merchandise manufactured in China is routinely being transhipped through other countries for the purpose of concealing Chinese origin, to circumvent quota restrictions. This transshipment network is surprisingly vast and involves transshipments and false origin claims through countries on every continent other than Australia and Antarctica.

I always thought those penguins looked honest.

When Nunez spoke to the Customs bar, Customs jump teams had been operated for some 20 months. During this period of time, Nunez said out of 694 factories inspected for production verification by these jump teams, 694 inspections, 553 factories were found to be transshipping goods produced elsewhere. That is a significant problem.

The Clinton administration has indicated that it wants to confront this problem, deal with it in a serious and deliberate manner, and the subcommittee wants to learn more about the administration's plans, what is in place already, and what is planned for the future at the hearing today.

Today, just to outline the schedule for the hearing, we will first take testimony from the General Accounting Office and then from the Customs Service. We will next hear from a panel of administration witnesses, including representatives from USTR, Commerce, Customs, and Justice. Customs will have the opportunity, of course, to respond to GAO's findings and then all the government witnesses will have an opportunity to present their views on the textile/apparel transshipment problem.

And, finally, we will hear from a panel of industry and labor representatives, three panels in all. But before we turn to the General Accounting Office to begin, I want to turn to Mr. Horn, who will be a member of our subcommittee as soon as the full committee meets and ratifies his appointment, and ask him on behalf of the minority if he has any opening statement that he may wish to make.

Mr. HORN. Thank you, Mr. Chairman. I am delighted to be here. I am going to let Mr. Cox make that statement or file it for the record when he arrives.

Mr. SPRATT. Mr. Green of Texas. Let me welcome our new member. He has just joined our panel, and we are delighted to see you here this morning.

Mr. GREEN. Thank you, Mr. Chairman, and I will be very brief. I have a much longer statement. After reviewing the GAO report and being a new Member of Congress, I was surprised that there would be that much transshipment and the problems that you pointed out in your opening statement. I am concerned about the inability of our government to effectively regulate the importation of foreign-made textiles and the implication it has for the North American Free Trade Agreement [NAFTA] that we will be voting on in the next few months.

If we can't ensure the content and prohibit transshipment of current trading agreements, how can we do the same thing with other nations, because that is one of the concerns that has been brought up in other subcommittees of the Government Operations Committee and also in my own district in Houston.

Can we be assured that this will be enforced with Canada and with Mexico? But I appreciate the chance to serve on the committee, Mr. Chairman. I have some experience in government oper-

ations in the Texas legislature and working with State agencies in combining functions, so I appreciate the chance to use that experience here. Thank you.

[The prepared statement of Mr. Green follows:]

GENE GREEN

**Subcommittee on Consumer, Commerce
And Monetary Affairs
October 5, 1993**

Mr. Chairman and members of the Committee
it is a pleasure to be here this morning at my first
hearing as a member of the subcommittee. I look
forward to working with the members of this
committee on a number of issues particularly like
the ones we are addressing today.

The inability of our government to effectively
regulate the importation of foreign-made textiles has
resulted in the erosion of an entire industry in this
nation and has cost us tens of thousands of jobs. I

am confident that we can correct this problem but it will require unprecedented cooperation between the Customs Service, the Immigration and Naturalization Service and our foreign trading partners. Given the fact that we will be voting very soon on the North American Free Trade Agreement, we must know that we can be confident in the trade agreements we reach with other nations.

The report by the General Accounting Office causes me great concern with the possibilities for NAFTA as well as for current practices involving the policies of the Customs Service. As you are all aware the mood of the public is extremely critical of government and that mood makes it all the more easy to take drastic actions to remedy problems.

While the recommendations of the National Performance Review are not final, I believe that we must begin to address the shortcomings in our trade structure if we are going to proceed with other trade agreements.

As a former member of the Texas Legislature, I have first hand experience of government reorganization programs and their ability to cause controversy among government agencies. As we address the recommendations made under the National Performance Review we should keep in mind that this controversy is often very healthy for the system. We made progress with a similar program in Texas and I believe that this success can be duplicated on the federal level.

Mr. Chairman I would like to thank you for calling this hearing and I look forward to working with you on this issue and any others that come before the committee. Thank you.

Mr. SPRATT. Pleased to have both of you join us.

Now, let's turn to the General Accounting Office. Mr. Chapin, the floor is yours. You prefiled your testimony. We will make it part of the record by unanimous consent, and you can proceed by summarizing it if you wish.

STATEMENT OF DONALD H. CHAPIN, ASSISTANT COMPTROLLER GENERAL, ACCOUNTING AND INFORMATION MANAGEMENT DIVISION, U.S. GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY JEFFREY C. STEINHOFF, DIRECTOR; AND GREGORY M. HOLLOWAY, ASSOCIATE DIRECTOR

Mr. CHAPIN. Thank you, Mr. Chairman. Members of the committee, it is a pleasure to be here this morning. I would like to introduce my colleagues at the table.

On my left is Mr. Greg Holloway, who was directly responsible as the Associate Director of GAO for the audit of the Customs Service. And on my right is Mr. Jeff Steinhoff, who is responsible throughout GAO for coordinating all of our efforts under the CFO Act.

As you know, we have done financial statement audits of the Army, the IRS, Customs, the Education Department, and a number of others. So Mr. Steinhoff is responsible for coordinating that work and has had considerable involvement in the audit of the Customs Service.

We are pleased to be here today, and we are here to discuss the results of our work, the first financial statement audit of the Customs Service covering its fiscal year 1992 financial statements. This very brief summary of our statement for the record will also touch very, very briefly on some broader but related government-wide financial management issues.

As I said, this is the first financial statement audit at Customs, and I would like to recognize Customs for its cooperation with us, for the responsiveness that it has given to our audit findings, and most importantly, to its strong efforts, which started before we began this audit, to implement the CFO Act. I think that full implementation of the act is going to go a long way to resolving Customs' financial and information management problems.

As you said, our audit identified some serious financial management problems that affect the efficiency and effectiveness of Customs' programs. Lack of critical information, inadequate financial systems and processes, and ineffective internal controls, not only made the financial statements unreliable and did not permit us to express an opinion, but they also contributed to loss of taxpayer funds and to ineffective trade regulation. I would like quickly just to touch on some of the effects of these deficiencies.

First, because of the weaknesses in its import examination processes, there is no assurance that the \$20 billion in duties that Customs recorded as revenues in fiscal year 1992 represents all the revenues that Customs should have collected for that year. Generally, Customs' examinations were limited to items voluntarily reported by carriers and importers on manifests and the entry documents, and therefore, would not have been likely to discover items that were omitted from those documents.

We observed that inspectors rarely looked at cargo being unloaded to determine that all shipping containers were listed on manifests and entry documents, or that they verified quantities of goods inside the containers. Further and very importantly, because Customs does not have a reliable means of assessing the effectiveness of its various examination efforts, it did not have a sufficient basis for managing its resources or for measuring overall compliance with the trade laws.

Second, with respect to Customs' duty refund practices, we found that procedures and controls were inadequate to prevent excessive or duplicate payments or to detect fraudulent claims. Customs made in fiscal year 1992 about a half a billion dollars of such refunds. So the amounts are large.

Third, Customs' accounting for almost \$1 billion in receivables probably takes a prize for inaccuracy and incompleteness. Efforts to collect receivables were hampered by missing documents, and the required surety bonds were insufficient in a number of cases. These unacceptable practices also cost taxpayers money.

Further, Customs' practices in mitigating assessed fines and penalties may result in failures to collect large amounts which should, in fact, have been collected.

Fourth, Customs' policies and procedures to control its half billion dollars worth of seized property were not consistently or effectively implemented. For example, seized drugs were not consistently weighed and tested, a practice that created an environment where drugs could be stolen without detection.

Fifth, Customs did not adequately control advances to its agents for special operations, and sensitive documents supporting special operations were not adequately safeguarded, thereby threatening the safety of informants and Customs' agents.

Sixth, Customs did not maintain adequate accountability and control over its own property and equipment, which is somewhere in the range of \$1 billion. As a result, these assets were vulnerable to theft and misappropriation.

Our longer testimony, which is provided for the record, contains a number of specific examples, the collective impact of which demonstrates the very weak financial management function, with a high cost to taxpayers and importantly with pervasive effects on Customs' ability to do its job to enforce the trade laws.

Customs has begun the process of strengthening its financial management operations. Over the last 2 years, the Customs Service has put into operation a CFO structure and has given the CFO the authority and the responsibility necessary to begin to correct many of the problems which we identified in our audit. Customs is also planning or implementing various improvements to its systems and processes, including the examination process. These efforts and continued implementation of the CFO Act can result in improving Customs' ability to collect its revenues, manage operations, and safeguard assets. However, some of these actions, many of them, in fact, are not expected to be completed for several more years.

Unfortunately, Customs' financial management problems are a microcosm of the similar problems throughout the Federal Government. Customs is not unusual. The lack of reliable information and

weak controls are crippling the ability of our leaders to effectively run the Federal Government and take the actions needed to reduce the Federal deficit and otherwise save the taxpayers money. Because credible financial data are not available today, public confidence in the Federal Government has been severely undermined.

The CFO Act is now almost 3 years old and has provided the needed foundation to correct these problems. The basic concepts are taking root. It still must continue to be fully and effectively implemented. The passage of the Government Performance and Results Act of 1993 and other initiatives to strengthen information management will also help to deal with these problems. And most recently, the National Performance Review under the auspices of the Vice President made a number of important recommendations to all agencies, including one that would fully integrate budget, financial, and program information, improve financial services, and strengthen debt collection.

For Customs specifically, it recommended organizational and management processes be modernized to provide an improved management structure and strategic vision. GAO made these kinds of recommendations a year ago in its comprehensive management review of Customs. But, I think a much greater sense of urgency is essential to successfully implement the needed reforms and to ensure that high potential savings to the taxpayers from the resulting improvements are realized as quickly as possible.

This is going to require sustained high-level attention to improve the financial management and resolve the financial management problems. It is going to require audited financial statements for all Federal agencies, not just the pilot agencies. It is going to require increased use of technology to improve our systems, our services, and our information. And most importantly, it is going to take strong congressional oversight and support.

Mr. Chairman, that is our opening summary statement. This panel is available for your questioning.

[The prepared statement of Mr. Chapin follows:]

United States General Accounting Office

GAO

Testimony

Before the Subcommittee on Commerce, Consumer and
Monetary Affairs,
Committee on Government Operations
House of Representatives

For Release on Delivery
Expected at
10 a.m.
Tuesday,
October 5, 1993

FINANCIAL
MANAGEMENT

First Financial Audit of
Customs Revealed Serious
Problems

Statement of Donald H. Chapin
Assistant Comptroller General
Accounting and Information Management Division



Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss the results of our audit of the Customs Service's fiscal year 1992 financial statements. We will also comment on broader governmentwide issues relating to financial and information management problems of the government.

The first financial audit at Customs shows that serious financial management problems exist and identifies related operating problems that affect the efficiency and effectiveness of Customs' programs. The results of this and other audits demonstrate the value of preparing and auditing annual financial statements and the need to accelerate governmentwide financial management reform through the full and effective implementation of the Chief Financial Officers (CFO) Act of 1990. Further, there are additional governmentwide steps that may need your consideration.

GAO has identified problems with Customs' internal controls which may require comprehensive management changes. In particular, we were unable to express an opinion on the reliability of Customs' fiscal year 1992 financial statements because of the lack of critical financial information, inadequate financial systems and processes, and an ineffective internal control structure. Internal controls were not designed and implemented to effectively safeguard assets, provide a reasonable basis for determining material compliance with certain laws and regulations, and assure that there were no material misstatements in the financial statements.

Customs has begun the process of strengthening its financial management processes and systems. Continued strong implementation of the CFO Act by Customs can result in a tremendous pay-off through an improved ability to safeguard assets, manage operations, and collect revenues. But the job will not be easy. Using audited financial statements as an important foundation to improve financial management, Customs will have to overcome the broad range of very serious problems that our financial audit has identified. This will require sustained, high priority management attention and congressional support.

SERIOUS WEAKNESSES EXIST IN
CUSTOMS' FINANCIAL MANAGEMENT
OPERATIONS AND CONTROLS

Some of the more serious problems identified through our financial audit of the Customs Service¹ include weaknesses in Customs' controls over import verification; refunds of duties; accounts receivable; seized property; and assets such as vehicles, vessels, and computer equipment.

¹Financial Audit: Examination of Customs' Fiscal Year 1992
Financial Statements (GAO/AIMD-93-3, June 30, 1993).

Weaknesses Over Import Verification
Create Opportunities for Lost Revenue and Fraud

Based on certain audit tests, we were able to conclude that Customs' reported revenues of \$20.2 billion for fiscal year 1992 approximate revenues actually collected from importers who voluntarily reported and paid amounts owed. However, Customs' internal controls did not provide reasonable assurance that all goods imported into the United States were properly identified and that the related duty was assessed. Therefore, we cannot give assurance that the \$20.2 billion represents all revenues which Customs should have collected for fiscal year 1992. Further, because Customs did not have a reliable means of assessing the effectiveness of its various inspection and enforcement efforts, it did not have a sufficient basis for managing its resources and measuring overall compliance with trade laws.

We found that most of Customs' examinations were limited to items voluntarily reported by carriers and importers on manifests and entry documents and, therefore, would not have been likely to discover items that were omitted from these documents. Inspectors rarely (1) observed cargo being unloaded to determine that all shipping containers were listed on manifests and entry documents or (2) verified the quantities of goods inside containers. Shipments that were inspected were selected primarily because Customs' experience indicated that they presented a high risk of violations.

For example, importers with records of previous violations or first-time importers were more likely to have their shipments inspected. However, these inspections involved only a very small percentage of imported goods, and because they were not selected in a representative manner, they could not be used to measure overall compliance.

In addition, systems designed to automatically monitor the movement and disposition of goods among warehouses, foreign trade zones, and other ports of entry were of limited effectiveness because important data on many imports were either not entered or not entered promptly. This occurred, in part, because many documents were submitted manually rather than electronically.

During fiscal year 1993, Customs began an effort to improve the value of its examination programs. For example, in response to our September 1992 report on Customs management,² Customs has taken steps to revise its random inspection process so that the results of these inspections can be used to estimate overall compliance with trade laws. If properly implemented, this should allow Customs to periodically remeasure compliance, improve its ability to develop strategies against noncompliant imports, and, thus, assess the effectiveness of changes in its inspections and enforcement programs. Since the new random inspection efforts have

²Customs Service: Trade Enforcement Activities Impaired by Management Problems (GAO/GGD-92-123, September 24, 1992).

only been performed on a limited basis since April 1993, it is too early to comment on their success. However, we plan to assess them as part of our audit of Customs' fiscal year 1993 financial statements.

An additional area that we are exploring as part of our 1993 audit is Customs' ability to enforce import quotas and rules of origin. An important aspect of this is preventing and detecting illegal transshipment of goods through an intermediate country by foreign exporters who wish to conceal the goods' true country of origin. Foreign exporters may engage in such transshipment in an attempt to circumvent quota restrictions and take advantage of lower duty rates on products from the intermediate country. Because physical inspections at U.S. ports of entry are not a reliable means of determining that a good's country of origin is correctly identified, Customs has undertaken some special enforcement efforts in this regard. For example, in certain countries, Customs has visited suspect foreign factories to determine their production capacity and inspect related records.

Controls Over Refunds of Duties Were Weak

We identified serious control weaknesses in Customs' duty refund practices. Customs refunds 99 percent of duties paid when the related imported merchandise is subsequently exported or destroyed. Customs reported that it made almost half a billion dollars in such

refunds, referred to as drawbacks, during fiscal year 1992. However, we found that procedures were inadequate to prevent excessive or duplicate payments or detect fraudulent claims. Specifically, Customs did not (1) adequately assess the validity of a drawback claim and track the amount of drawback paid against an import entry, (2) establish sufficient review procedures to ensure that a claim was accurate, (3) ensure that required bonds were adequate, and (4) ensure that only authorized claimants received accelerated³ drawback payments. Available documents did not enable us to determine the extent of losses from these weak controls.

Inadequate Controls Over Accounts Receivable

The \$828 million Customs reported as accounts receivable as of September 30, 1992, was inaccurate and incomplete. Customs' internal controls over accounts receivable were so poor that we could not gain assurance that all valid receivables had been identified. Further, even when valid receivables were identified, they were not always included in Customs' reported amounts. When included in reported amounts, some receivables were recorded at a net collectible amount rather than at the proper gross amount. Other amounts that were recorded could not be supported by available documentation. We were unable to determine the losses

³Accelerated drawback payments are made to authorized claimants prior to Customs reviewing and verifying the validity and accuracy of the claim. Nonaccelerated claims are paid after Customs reviews them. Therefore, accelerated payments represent a greater risk than nonaccelerated payments.

that may have resulted from these poor controls, but the amounts could be large.

Also, Customs had not developed a reliable methodology for estimating the amount of its recorded receivables that is likely to be collected. Customs' methodology was flawed because it was primarily based on historical collection experience without considering debtors' current ability to pay. Our review of \$403 million of valid receivables as of June 30, 1992, showed that Customs' estimate of the collectible amount of these accounts receivable was overstated by about \$41 million.

Efforts to collect delinquent debt were hampered by missing documents. In our sample of 966 cases, Customs could not locate 144 key documents, involving 127 cases, needed to support its claims against the importer or the surety that had guaranteed payment. In addition, Customs did not effectively monitor whether surety bonds were sufficient to cover amounts owed by importers, which gave rise to delinquent and, in some cases, uncollectible accounts receivable. In one instance, a petroleum importer, with 15 outstanding bills totaling about \$3.1 million, had a continuous surety bond of only \$400,000. Customs pursued collection from the surety and collected the bond amount. However, the remaining \$2.7 million was not covered by the bond and is most likely uncollectible because the importer is more than 4 years delinquent in paying this debt.

Customs' ability to collect delinquent debt is further hampered by existing law which prohibits Customs from using private collection agencies to pursue payment, an option which is available to most other federal agencies. The recently issued report of the National Performance Review⁴ proposes that this restriction be eliminated.

Finally, large differences existed between the amount of fines and penalties assessed, mitigated, and collected. Overall, Customs collected pennies on a dollar of assessed fines and penalties. Violators, who are aware of these differences and Customs' practice of mitigating most assessments, may routinely petition for mitigation, requiring Customs to devote large amounts of resources to the mitigation process. While Customs does not routinely report data that correlate individual assessments to collections, we found that only a small fraction is being collected. As a measure of the potential difference, during the past 2 fiscal years, Customs assessed fines and penalties totaling approximately \$7.9 billion and collected only about \$87 million for various fines and penalties cases, including cases opened in earlier years.

According to Customs' officials, such differences result primarily from (1) the statutory requirements that Customs assess fines and penalties in large amounts and (2) Customs' practice of mitigating most accounts to nominal amounts. Violators, who are aware of

⁴Creating a Government That Works Better And Costs Less, report of the National Performance Review, September 7, 1993.

these differences and Customs' practice of mitigating most assessments, may routinely petition for mitigation. We found that some assessments are mitigated because Customs did not have sufficient documentation at the time of assessment and later mitigated the assessment to reflect documentation provided by the importer. For example, Customs assessed a penalty amount of about \$4.4 million to an importer for allegedly fraudulently undervaluing merchandise being imported. The importer filed a petition with Customs and provided additional information, and the penalty was reduced to \$150,000.

We were unable to determine the appropriateness of such mitigations and any losses that may have occurred as a result of inappropriate penalty assessment or mitigation policies. However, because such large mitigations would seem to diminish Customs' credibility and the deterrent effect of penalizing violators, we are examining this area further as part of our audit of Customs' fiscal year 1993 financial statements.

Weak Accountability for Seized Property
and Special Operations Documents

Customs reported \$542 million in seizures during fiscal year 1992 and an ending balance of \$489 million in seized property in its financial statements. However, Customs' policies and procedures to control seized property were not consistently and effectively

implemented. We identified weaknesses in internal controls throughout Customs' seizure process, from the time property was seized to the time of its disposal. As a result, seized property was vulnerable to theft or loss, which could result in financial loss to the government or danger to the public.

The following are examples of control breakdowns.

- The transfer of seized property from seizing officers to seizure custodians for safeguarding was often delayed. Over 50 percent of the 118 items we tested were not transferred within Customs' prescribed 2-day maximum--the average was 35 days. In one instance, about one-half pound of heroin was held by a seizing officer from August 11, 1992, the date of the seizure, until March 16, 1993, when we visited the Customs' district involved. Officials at the district office, including the seizing officer, could not explain the reason for the delay.
- Seized drugs were not properly weighed and tested, a practice that created an environment where drugs could be stolen without detection. For instance, although Customs had established procedures to weigh drug seizures, we found a case where a shortage of 1,850 pounds of seized marijuana could not be accounted for. Customs was unable to explain the discrepancy other than to state that the initial weight assigned to the

marijuana was probably an estimate and that the seizure had not been weighed as required at the time of receipt.

-- Storage facilities were not properly protected. At 14 of the 20 Customs' seized property storage facilities we visited, we observed that unaccompanied seizure custodians had access to vaults. None of the 20 Customs districts we visited had security cameras in their vaults, and 2 sites containing large bulk quantities of drugs had open physical access in full public view.

Further, Customs did not adequately control millions of dollars in funds advanced to its agents for special operations, such as undercover work and payments to informants, or properly secure the sensitive documents related to these advances. More serious though, sensitive documents supporting special operations transactions were not adequately safeguarded. At Customs' National Finance Center, such sensitive documents were routinely stored in an open filing cabinet in an unlocked room or were left unattended on a desk. Failure to adequately protect these documents could threaten the safety of informants and Customs' agents, compromise important relationships with informants, and undermine Customs' credibility.

Customs Lacked AdequateAccountability for Property

Customs reported property valued at \$710 million at September 30, 1992. Although the vast majority of this amount was attributable to items such as aircraft, vehicles, vessels, and computer equipment which could be attractive targets for theft, Customs had not implemented effective property controls. For example, although Customs had performed a physical inventory of equipment in fiscal year 1992, we found \$6.2 million of computer equipment on hand which was not included in the property records. Further, Customs was unable to support the values assigned to over 50 percent of the 650 property items we sampled and tested.

In reconciling its accounting records with the related detailed subsidiary property records for fiscal year 1992, Customs made adjustments totaling \$115 million. But for many of these adjustments, Customs did not know whether the adjustments represented property that was simply not recorded, incorrectly recorded, or misappropriated or stolen.

Customs' FMFIA Reporting

Customs did not report the severity of its internal control and accounting system weaknesses in its fiscal year 1992 Federal Managers' Financial Integrity Act (FMFIA) report. Customs' self-

assessment process did not adequately identify material weaknesses because (1) staff who performed the reviews were not provided with sufficient guidance and training, (2) the tools used to perform the reviews were inadequate, and (3) management oversight was ineffective. In addition, some previously identified material weaknesses that Customs reported as corrected still existed because Customs did not address the fundamental causes of those weaknesses or ensure that corrective actions were effectively implemented. Customs' FMFIA process must be improved if the agency is to better control costs and improve its operations.

Actions by Customs to Improve

Financial Management

For years, until the passage of the CFO Act, Customs lacked financial management leadership with sufficient expertise, responsibility, and authority to ensure that its financial systems, processes, and internal controls fully supported its financial information needs. Over the last 2 years, through the strong support of the Commissioner and Customs' top management, the agency has put in place a CFO structure and given the CFO the authority and responsibility necessary to begin to correct many of the problems identified in our audit. During 1992, for instance, the agency installed a new core general ledger system which became effective October 1, 1992.

Customs is either studying, planning, or implementing various improvements to its systems and processes. It is in the process of redesigning its Automated Commercial System, which was developed to automate information on Customs' program operations and is used to account for revenue collected, and it has begun development of a new cost accounting system. Customs has also begun to modify its methodology for estimating the collectibility of its accounts receivable and has made positive strides towards addressing its debt collection problems. Further, Customs has taken steps to resolve long-standing problems in its property records and is planning additional efforts.

The success of Customs' ongoing computer modernization efforts and planned procedural improvements will be critical to improving its financial management systems and internal control structure. Many of these efforts, though, are not expected to be complete for several more years. As a result, it will take a significant and sustained commitment by Customs' management to build on efforts now underway to develop new systems and put proper controls in place.

These efforts have recently gained additional support from the National Performance Review (NPR). The NPR's summary report, which I previously mentioned, recommends that all agencies (1) fully integrate budget, financial, and program information, (2) use the CFO Act to improve financial services, and (3) strengthen debt collection programs. For Customs specifically, it recommends that

Customs' organization and management processes be modernized to provide an improved management structure and strategic vision. The NPR plans to issue additional, more detailed reports that may elaborate on these recommendations and allow us to better assess the specific actions that the NPR thinks need to be implemented.

REACHING FOR FINANCIAL MANAGEMENT REFORM: SUCCESSFUL
IMPLEMENTATION OF THE CFO ACT MUST BE A HIGH PRIORITY

This leads me to the broader issues of the government's financial and information management problems. As discussed in our December 1992 transition series report on Financial Management Issues (GAO/OCG-93-4TR), widespread financial management weaknesses are crippling the ability of our leaders to effectively run the federal government. We have raised similar concerns about information management. Reducing the federal deficit requires monumentally difficult decisions. If our government is to make these decisions in an informed manner, it must have better information. Also, our citizens should be provided meaningful information that allows them to judge the performance of their government and controls that help guarantee fundamental accountability. Because credible financial data are not available today, public confidence in the federal government as a financial steward has been severely undermined.

There is no magical formula to solve these problems. The issues are very complex, deeply rooted, and involve the largest entities

in the world, which have no counterparts in the private sector--the federal government is clearly different. Nevertheless, successful financial and information management reform can and must be achieved.

The CFO Act, now almost 3 years old, has provided the needed foundation and is the most comprehensive financial management reform package in 40 years--but it must be fully and effectively implemented. Many important initiatives are underway and planned, and the basic concepts of the act are taking root. The passage of the Government Performance and Results Act of 1993, which requires federal agencies to articulate clear outcome-oriented program goals and measure and report on progress towards achieving those goals will also help, as will other initiatives to strengthen information management. But a much greater sense of urgency is essential to successfully implement needed reforms and to ensure that the huge potential savings to the taxpayer from the resulting improvements in the efficiency and effectiveness of government are realized as promptly as possible. I would now like to highlight some of these critical actions.

Ensuring Sustained High-Level Priority

Attention to Resolve Financial Management Problems

Only through consistent and continuous attention from the highest levels of government and the Congress, including agency CFOs with

requisite skills and experience and the needed powers and authority to get the job done, will we see the results that are possible. Without decisive action by the new administration and strong oversight and support by the Congress, efforts to reform financial management will falter. There must be a sense of urgency. Changing a government culture that has not always seen financial management as important is difficult, especially if there is not a continuity of effort or if this change is not perceived as important.

The President must hold agency heads accountable for successfully implementing the CFO Act. There has to be an increased emphasis on professional management. In our view, the success of financial management reform is critical to any effort to reinvent government.

Agencies must give high-level attention to financial management improvements. For example, the recent announcement by the Department of Defense that it had established a senior management steering committee, chaired by the Deputy Secretary, to bring together financial, program, and information management, was encouraging. An appropriate framework for integrating accounting, program, and budget systems and data is needed to develop more useful and relevant information for decision-making and to break down traditional barriers between program management on the one hand and financial and information management on the other. Further, the central management agencies--the Office of Management

and Budget, the Department of the Treasury, and GAO--must expedite sorely needed accounting, financial reporting, cost, and systems standards. The NPR set an 18-month deadline for the Federal Accounting Standards Advisory Board to provide the central agencies with its recommendations for accounting and cost standards. We must also find a way to accelerate the setting of systems standards.

The CFO Act established a Controller in OMB to provide overall leadership and CFOs to direct and control financial management activities in major departments and agencies. A highly qualified Controller is urgently needed to steer this effort, with the authority to lead the CFOs in the major departments and agencies and the resources to do the job. Unfortunately, no one has yet been nominated for this important position. The administration must also appoint agency CFOs who are highly qualified financial management professionals, with the right mix of properly defined duties and full authority for traditional financial management functions, including budgeting. But at most agencies, the CFO has not yet been appointed.

Expanding Audited Financial Statements to the Entire Federal Government

As the Comptroller General has stated on many occasions, GAO is firmly convinced of the value of audited financial statements. The

results of the pilot financial audits at the Department of Defense and the civilian agencies further reinforce this belief.

We fully support the OMB Director's recent decision to extend the CFO Act pilot audits and establish a March 1 reporting date to tie in with the budget cycle. OMB's continuing strong support of audited financial statements and the leadership of its Office of Federal Financial Management have been very important to the success of this program.

To further build on this success, it is now time to expand the requirements for agency level audited financial statements beyond the 10 pilots to cover all the agencies identified in the CFO Act. This is essential to meet the NPR deadline of having an audited consolidated report on federal finances in 1997. For the first time, the American public would be given an accountability report from its government. We believe it would be best for these requirements to be anchored in legislation.

Also, the preparation of audited financial statements, including required performance information on the results of operations, would support the implementation of the Government Performance and Results Act. In my view, implementation of this important new legislation can be greatly aided with good cost and operating performance information that audited financial statements under the CFO Act are intended to provide.

Making Wise Investments in Systems
and Personnel to Rebuild Financial
Management Infrastructures

Today, it is well acknowledged that current financial systems across government are in extremely poor condition, despite billions of dollars in improvement efforts over the years. Customs, for example, struggled in preparing reliable financial statements primarily because of severely weak systems. This has to be overcome through wise investments in modern systems that enable streamlined operations and have a dollar pay-off in terms of better information and better efficiency. While investment in new systems is essential, it is important that the billions of dollars that are already being spent on systems every year are used more effectively to develop systems that will meet government information needs.

The CFO Act calls for integrated systems, meaning financial and operating systems that are interconnected to support both agency business plans and management information needs. There must be increased emphasis on using information resource management to facilitate agency reengineering projects. Reform cannot be viewed merely as further automating existing processes. Rather, those processes must be simplified, redirected, and reengineered.

An equally important step is breaking down traditional barriers between program and financial management systems so that financial

management information supports programs, missions, and business lines. For example, by periodically measuring compliance with trade laws, Customs can provide a means of also determining the cost-effectiveness of various enforcement techniques and ensuring that resources are used wisely. Further, efficiencies could be gained through more standard systems and more "cross servicing" in which one agency provides accounting services (such as payroll and disbursing) to another agency. The development and use of governmentwide systems development standards to better guide system design and implementation efforts would be a vital component in such efforts.

The federal government must immediately address the serious problem of attracting and retaining well-qualified financial management personnel. Agencies reported a significant need to upgrade their financial management staff capabilities. In our financial audits, we have found that bad systems are made even worse because people do not properly process transactions. We have identified tens of billions of dollars of accounting errors that could have been avoided if there had been more discipline in following existing policies and procedures. Financial managers must upgrade their training efforts to increase professional skills.

The NPR report calls for retooling the government's management systems and using information technology throughout the federal government. We in government can and should develop the standards

to enable this to happen. We are now working with OMB and Treasury, through the Joint Financial Management Improvement Program, to accelerate standard setting, and consideration should be given to further focusing attention through Chief Information Officers at the agencies. But getting the information systems actually put in place, which will permit accounting, cost, and systems standards and objectives to be implemented during the term of this administration, is a tremendous challenge. We will need people with the knowledge to maximize the effective use of technology. The record in the federal government is one of failed systems development efforts even with traditional contractor-type assistance for these efforts. With more than \$20 billion a year being spent on systems development by government agencies, agency after agency still lacks critical information needed to analyze programmatic issues, manage agency resources, control expenditures, and demonstrate measurable results. The record is essentially one of each agency trying to develop its own accounting systems. The NPR calls for innovation funds where agencies pool their monies to fund cooperative efforts. Such governmentwide efforts have been negligible in the past. Agencies, for example, do only a limited amount of centralized data processing despite the fact that the cross servicing that has been done has been relatively successful. We have to guard against ad hoc agency efforts that duplicate what someone else has already done. Also, new financial systems will need to include good planning, cost, and evaluation modules necessary for adequate management information. These kinds of

management information features in government systems will be necessary to enable and facilitate achievement of the NPR's government service and dollar savings goals.

Government will have to find ways to effectively engage agency managers and the people in the private sector in helping to satisfy governmentwide needs. NPR, in proposing innovation funds, speaks of breaking the barriers to cooperative efforts by federal agencies. We in government have to find a way to expedite efforts to provide the systems models and pilots needed. In this context, the executive branch should explore various alternatives to collectively engage agencies and the private sector in the production of model information systems sufficient for basic governmentwide planning, budgeting, management, accounting, and evaluation functions. Such a system would have to have the flexibility to accommodate the special and specific operating needs of the individual agencies.

Implementation of new systems that eliminate the duplicative and manual processes that agency systems require today should enable agencies to decrease the size of their staffs. But, they may need more skilled professionals, such as financial analysts and cost and systems accountants, in the short term as basic deficiencies are addressed. People, such as additional skilled electronic data processing professionals, will need to be recruited into government. Further, to ensure a cadre of professional managers,

we support mandatory continuing professional education similar to the requirement now in place for auditors.

Fostering Reforms Through Strong
Congressional Oversight and Support

The Comptroller General has spoken many times about the importance he places on annual congressional oversight hearings of agency management. Managers must be held accountable for results. The annual agency CFO report, which includes audited financial statements, together with the reporting required under FMFIA, can provide a baseline for such hearings.

In the case of FMFIA, these reports have to be meaningful and must be used or else they will not be taken seriously. Greater accountability can be established through reporting that combines the agency CFO and FMFIA reports and focuses on outcomes and results which are scrutinized by annual congressional oversight hearings.

Finally, in difficult budget times, and where the pay-off may not be immediate, funding for financial and information management improvements will need to be viewed as investments. For the CFO Act to succeed, the Congress will have to provide the necessary funding support through investments in modern systems, personnel

staffing and development, and expanded financial reporting and auditing.

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In closing, I want to emphasize that the CFO Act has had an important impact in changing perceptions about the need for good financial management, and agencies have made improvements and are working in response to the act to significantly strengthen their financial processes and systems. It has had that effect at Customs. But it will take a great deal of commitment and hard work for Customs to achieve the full potential and objectives of the CFO Act and the other initiatives I have mentioned: good accounting, controls, systems, and measurement are important underpinnings that are necessary for the success of many of the NPR initiatives and for improving the efficiency and effectiveness of government.

Mr. Chairman, this concludes my statement. I will be glad to answer any questions that you or the other Members of the Subcommittee may have at this time.

Mr. SPRATT. Thank you very much, Mr. Chapin. You indicate that the Customs Service is not unique in the Federal Government. It is a microcosm, it is a cross-section of the experience you found in all the agencies you have audited so far.

Is this the first time GAO has performed an audit of this scope on Customs?

Mr. CHAPIN. Yes, it is, sir. This is the first financial statement audit of Customs that has ever been done. It is certainly our first effort.

Mr. SPRATT. So this is the auditor's first brush at the books Customs has been keeping, and you found them very deficient from your standpoint?

Mr. CHAPIN. Seriously deficient, yes.

Mr. SPRATT. Has a chief financial officer been appointed for Customs?

Mr. CHAPIN. Yes, sir. Mr. Brainard has been the chief financial officer, I believe, for about 1½ years. He is behind me sitting in the audience. He has been an effective factor in pulling together Customs' efforts to try to remedy some of these problems.

Mr. SPRATT. Has the government itself, the Federal Government through the GAO, through the Treasury Department, implemented accounting standards that all agencies and departments are supposed to follow?

Mr. CHAPIN. No, sir. There are some serious problems. If you look at the National Performance Review, you will see the Vice President made a number of recommendations to accelerate the setting of standards, accounting standards primarily and called for cost standards, but information standards as well need to be in place. This government has a long way to go before it really has the right kinds of systems and controls to handle the funds that the taxpayers have provided to the agencies. We have a lot of work to do.

Mr. SPRATT. Have you also looked at the Internal Revenue Service?

Mr. CHAPIN. Yes, sir.

Mr. SPRATT. Were you able to certify their statement in full last year?

Mr. CHAPIN. No, sir, the result was very similar to Customs. The similarities are amazing between the two agencies of the Treasury.

Mr. SPRATT. Well, does this partly derive from the culture of government agencies, they haven't traditionally booked assets, depreciated assets, kept property accounts as a private corporation would? Is this part of the reason for the problems?

Mr. CHAPIN. This has been the culture of our government. There has been little attention to financial management or for that matter to management of the agencies. We have been engaged in policy and in trying to do things, and I think there has been a widespread failure to recognize the underpinnings, the information underpinnings, the controls underpinnings to conduct effective government. That has been a widespread failure throughout the government for a number of years.

We are fortunate that the Congress recognized this problem 3 years ago and passed the CFO Act.

Mr. SPRATT. In the case of an agency like Customs or the Internal Revenue Service, both of which have substantial flows of money, have you found that the lack of accounting standards and the lack of accountability for property records and physical properties and the inability to reconcile receivables has led to inordinate misappropriation or unaccounted for moneys?

Mr. CHAPIN. I would like to answer the question this way and sort of go through some of the Customs issues with you for a minute. If you look at the receivable situation, which we describe in our report, and if you look at how the draw back system is operating, huge amounts of moneys are involved in both. There could be hundreds of millions of dollars that are being lost just because of the management and financial management practices that are involved in those issues.

If you look at the lack of presence in the foreign trade zones or in the bonded warehouses of Customs agents, or if you look at the huge mitigation of penalties, it is extraordinary. Billions of dollars are assessed, and only 1 or 2 percent are actually collected. When you look at those issues, you begin to wonder, how much money can be involved in a better administration of the Customs Service, and when you finally get to trade, the huge amount of trade that comes into this country, Customs doesn't really know accurately what the level of compliance is. Customs hasn't yet got to focus on some of the industry areas and the high-risk areas that would really tell what level of compliance is out there. Again, it has got to be a lot of money, if you are assessing upwards of \$1 trillion and collecting \$20 billion.

This is not only a money issue, I know there is a trade issue, too. But, there is plenty of money involved and that is what makes it very important that Customs comes to grips with these issues.

Mr. SPRATT. You anticipated my next question. If Customs were better organized, would the Federal Government derive more revenues from it, in your judgment?

Mr. CHAPIN. No question about it. There is a huge potential here to improve the collection of moneys and the management of the assets of Customs.

Mr. SPRATT. You found their systems deficient. Have you any opinion about the adequacy of their people to do all of the tasks assigned to them as well as the housekeeping functions, keeping account of accounts receivable, physical property records, and things of this sort?

Mr. CHAPIN. That is a broad question. I would say the nucleus of the group that has been pulled together under the Commissioner to deal with the financial management issues seems to be on the right track and are doing the right job. But again, we have found in Customs, as elsewhere, that some of the problems that exist are due to the fact that people on the line that are doing the jobs are not doing them the way they should.

We don't have the kind of financial management discipline in government that we should have to do the job well. I think even with the existing practices and procedures, a lot better job could be done if our people did what they were supposed to do. So I think we have a management problem out there. Not that people are unwilling to work or don't want to do a good job, I think everybody

does. It is a question of how they are managed, what they are asked to do, and how accountable they are held.

Mr. HOLLOWAY. Mr. Chairman, the only thing I would add to that, and Customs would certainly be in a better position to assess the technical capability of its people in terms of do they have enough of the right mix of people, I would say that if you look at financial management in Customs, which is pretty similar to most agencies, any time you place a low priority on something, the transformation that has to take place to get to where you want to be, clearly will require more of the right kinds of people to get the job done.

I would agree with Mr. Chapin in that Customs is putting people, the right kinds of people, in place. Whether or not they have enough of them to try to turn around the systems issues that they have to deal with, as well as some of the accounting issues that they have to deal with to account for their operations, they would be in a much better position to talk about their needs.

Mr. SPRATT. Customs relies to a great extent on voluntary compliance and uses third parties, in many cases brokers, to assess, collect, and remit duties and tariffs. Given the deficiencies you found in their accounting systems and the admitted stretch out of personnel, are you comfortable with this system?

Mr. CHAPIN. No, sir. Customs has undertaken to try to find out more about its level of compliance in various areas, as I mentioned earlier. I think that is very important because, if you know where the problems are, that is where you can focus your resources. It is possible, if we really find out the level of compliance is not what Customs has said it was, that Customs should consider coming to the Congress for more resources. After all, we have had a huge growth in trade, with very little expansion in Customs' personnel levels.

We are dealing with a much bigger situation here. And with so much money involved, I think it is important to understand the potential revenue sources and to understand whether or not the level of resources the Congress has provided to Customs is sufficient to do the job.

Mr. SPRATT. Well, Customs frequently tells us, and I think it has a right to, the volume of revenues collected per dollar expended on Customs personnel. And we have argued before that at the margin additional dollars spent on more personnel engaged in detection and collection would yield a substantial multiple in revenues of the cost of adding on these personnel.

Are you confident with that, that if we added on more personnel, enforcement personnel, auditing personnel, that we would see a multiple of revenues several times more than the cost?

Mr. CHAPIN. I would like to invest in that situation, sir. I think that would be money well spent. And, it is clear to me that with more resources, Customs can do a better job and bring more revenue in.

Mr. STEINHOFF. There is another cut to that, though, and it deals with the basic systems. The government—Customs, IRS, no matter where you are—has to do a much better job of using existing technology. Sometimes agencies approach to making processes more effective is try to automate those processes. But we have to first ex-

amine the basic processes in government, reengineer them when they don't make sense, and then properly use technology which will ultimately allow you to do a lot more with the people you have. You might have to have a different type of person, but you are in a much better way using what is available today.

Mr. SPRATT. Well, do you believe that H.R. 700, the so-called Customs Modernization and Informed Compliance Act, will help Customs address these financial problems and also automated processes and make better use of its resources, and as a result collect more revenues?

Mr. CHAPIN. In preparation for this testimony, Mr. Chairman, I really have had an opportunity just to read this bill. It is similar to a bill that we supported a couple of years ago. As I recall, though, in that bill we favored inclusion of performance measurement for the Customs Service.

I don't know whether that is in the present bill or not. So I am not really prepared to tell you whether that bill is totally comprehensive enough to deal with the problems that we see. But clearly, it attempts to do so in terms of the management issues that we found in our general management review and what we found in the audit itself.

Mr. HOLLOWAY. I think the only thing I would buffer that with is that certainly anything that would serve to modernize and improve efficiency and those kinds of things, we would support. But I think along with that you need to make sure that you move to an environment that also is secure and addresses some of the issues here. It is not enough to just do it faster.

I think you want to not only do it faster, but you want to do it right. If I could regress just for a second on the people issue. I think the thing that I would at least say we ought to initially look at is what Customs has now in the way of personnel, and some of the restraints to the extent that they exist. Based on conversations with Customs, there are some legislative restraints on how they deploy their resources. We should look at how you might alter that some to give them a chance to redeploy their resources, as Jeff Steinhoff talked about in a reengineering process, so they could put people where they felt they needed people to do the job that they needed to do. And then after having done that, if then you find that resources are needed, then maybe a move to give more resources should be pursued. I don't know that adding resources is necessary right now—Customs has a lot of people.

I think one of the things that needs to be looked at is whether the current mix of people is being optimally used.

Mr. CHAPIN. My colleagues were quite right to correct the impression I gave. We certainly would support understanding the problem, properly deploying the resources that the Customs has, and then deciding whether or not to add additional people.

Mr. SPRATT. Thank you for your testimony.

Mr. Horn.

Mr. HORN. Thank you, Mr. Chairman. A number of questions. You say this is the first financial audit that the General Accounting Office has conducted of Customs?

Mr. CHAPIN. Yes, sir.

Mr. HORN. Since when? The 1921 Budget and Accounting Act?

Mr. CHAPIN. Well, I don't go back quite that far. But, I don't think we have ever done a full-fledged financial audit on the Customs Service.

Mr. STEINHOFF. Financial statement audit.

Mr. HOLLOWAY. I was going to say, we probably ought to clarify that a little bit. An audit can take many forms and shapes.

GAO has done a number of efforts in the Customs agency. A couple years ago we looked at their enforcement efforts, and last year we did a general management review, which was a pretty broad sweeping effort. So we have done audits in the Customs Service.

What we are talking about here is a financial statement audit. And if you want to correlate that to something that is a very common practice in the private sector, it is where we are going in to evaluate their books and records. A lot of our other work is focused on the program efforts in Customs in terms of the policy and the effectiveness of the programs.

Mr. HORN. How many of that type of financial audit have you done in the Federal Government?

Mr. CHAPIN. Well, we started a financial audit process before the passage of the CFO Act 3 years ago. We initially started with some of the agencies that now have progressed to the point where they are getting clean opinions. So we would anticipate that as the government audit function expands under the CFO Act and covers these agencies, including Customs, that we are going to see the kind of remedial effect that you see in the private sector when audits are done.

If an agency has problems, we lay them out the first year. The second year, there is some improvement, and they are working on the systems. The third or fourth year, maybe we see a virtually clean opinion. We hope that that is the way the process will work. It has happened in other situations. We think we have got the right medicine for this problem, but it takes a while for it to go.

Mr. HORN. Could you furnish for the record the names of the agencies that have had this type of audit?

Mr. CHAPIN. Yes.

[The information follows:]

Request for information for the record by Representative Steve Horn

FEDERAL AGENCIES HAVING FINANCIAL STATEMENT AUDITS

Agency Audits

General Services Administration (GSA)

GAO began financial statement audits of federal agencies with the fiscal year 1985 audit of GSA, performed fiscal year 1986 and 1987 GSA audits, and audited the GSA Federal Supply Fund portion of the fiscal year 1988 audit. GSA hired a CPA firm to perform the balance of the fiscal year 1988 audit and subsequent annual audits.

Veterans Administration (VA)

For fiscal year 1986 GAO performed the initial financial statement audit of VA and continued to perform subsequent annual audits through fiscal year 1989 when the VA Inspector General took over the audit responsibility to perform subsequent fiscal year financial statement audits, including 1990 through 1992, under the CFO Act.

Environmental Protection Agency (EPA)

For fiscal year 1987 GAO performed the initial financial statement audit of EPA and the financial statement audit for fiscal year 1988. No subsequent financial statement audits have been performed of EPA except for the legislative required audit of Superfund obligations and outlays by a CPA firm.

Department of Labor

The Department of Labor Inspector General with assistance from CPA firms performed financial statement audits of the Department beginning in fiscal year 1987 and has continued to perform subsequent year audits, including 1990 through 1992, under the CFO Act.

Social Security Administration (SSA)

The Department of Health and Human Services Inspector General performed financial statement audits of SSA beginning in fiscal year 1987 and have continued to perform subsequent year audits, including 1990 through 1992, under the CFO Act.

U.S. Air Force

For fiscal year 1988 GAO performed the initial financial statement audit of the U.S. Air Force and the financial statement audit for fiscal year 1989. No financial statement audits were performed for fiscal years 1990 and 1991 and fiscal year 1992 was audited by Air Force Audit in accordance with the CFO Act.

U.S. Department of Agriculture (USDA)

For fiscal year 1988 GAO also performed the initial consolidated financial statement audit of USDA. Financial statement audits of certain USDA agencies were performed in 1989 by the Inspector General and CPA firms, as well as annual consolidated financial statement audits for fiscal years 1990 through 1992 in accordance with the CFO Act.

Department of Housing and Urban Affairs (HUD)

Components of HUD obtained financial statement audits by CPA firms beginning in fiscal year 1989 who have continued to perform subsequent year audits, including 1991 and 1992 under the CFO Act.

U.S. Army

For fiscal year 1991 GAO performed the initial financial statement audit of the U.S. Army and the financial statement audit for fiscal year 1992 under the CFO Act. Fiscal year 1993 is being audited by the Army Audit Agency in accordance with the CFO Act.

Department of Education

For fiscal year 1992 GAO performed an initial financial statement audit of the Student Loan Program under the CFO Act and is presently conducting a fiscal year 1993 audit.

Department of Treasury

GAO also performed initial financial statement audits of the Internal Revenue Service and the U.S. Customs Service, under the CFO Act and are presently conducting fiscal year 1993 audits.

Other CFO Act Audits

Under the CFO Act, government trust funds, revolving funds and commercial activities are required to prepare financial statements and have them audited.

Government Corporations

GAO has performed financial statement audits of many government corporations under the Government Corporation Control Act (passed in 1945) and other enabling legislation. With the passage of the CFO Act in 1990, the 33 government corporations subject to the Act have the responsibility to obtain an annual financial statement audit and most have hired CPA firms. Under the CFO Act and other legislation GAO has the authority to audit the government corporations as necessary and has exercised that authority to perform financial statement audits of the Resolution Trust Corporation, Pension Benefit Guaranty Corporation, and the three Funds which comprise the Federal Deposit Insurance Corporation.

Legislative Branch Operations

GAO performs annual financial statement audits of about 20 legislative branch operations and periodic financial statement audits of about 10 other legislative branch operations. Examples of these operations are the Senate and House recording studios, the Senate restaurant, the House finance office, Capital Preservation Fund, and the Environmental and Legislative Study Conference.

Mr. HORN. You are saying this type you feel could not have occurred before the Chief Financial Officers Act?

Mr. CHAPIN. We, as you know, have the authority to audit anything in the Federal Government.

Mr. HORN. Right.

Mr. CHAPIN. Our efforts have been expanded since the passage of the CFO Act. That put the congressional focus on this issue and required the agencies to prepare audited financial statements. And we supported the effort, and we responded to it. Since the act has passed, we have conducted financial statement audits of the Air Force, the Army, IRS, Customs, and the Student Loan Program.

Mr. STEINHOFF. In the years just prior to the act, we also did VA and GSA.

Mr. HOLLOWAY. Right, and Agriculture. Another pool of audits we have routinely done in this manner are entities called government corporations. I think what is new is financial statement audits of the executive branch agencies. There have not been that many executive branch agencies' financial statement audits done.

Mr. HORN. How would you differentiate the financial statement audit from what is known as a management audit, where you look at what they are authorized to do, you look at the structure they have developed to carry out the implementation of either law or Executive order, and then you make judgments as to the effectiveness of that system of management?

Mr. CHAPIN. Well, that type of audit you described is what GAO has done traditionally.

Mr. HORN. Right.

Mr. CHAPIN. The financial audit is very similar to what a CPA firm does when it goes out to audit General Motors. We look at the books, we look at the internal controls, and we look at the financial aspects of the agencies. When we do these financial audits though, that are primarily directed at expressing an opinion on the financial statements, we go further in the government than the CPA firm generally does. We look at the specific controls and try to form an opinion as to whether those controls are adequate. We look at such issues as are the assets safeguarded, is the agency getting the proper kinds of reports, not only the financial statements, but are they getting the proper kind of information to effectively manage their operations? We also go a good deal further than that and try to link the results of the work with the programmatic efforts of the agency.

We try to understand from the point of view of the financial statements and the financial controls work we do, how the agency could be more efficient and more effective. That is why, for example, in this audit of the Customs, we looked carefully at the system of sampling by which they determine the level of compliance for various trade laws. So, we go a bit further than the CPA's would normally do.

Mr. HORN. In developing this audit, have you talked to the chief financial officer of the Treasury as to the degree to which he or she had become involved in similar reviews?

Mr. STEINHOFF. Early on we had discussions with them. For the most part, if I were to characterize the relationship, both IRS and

Customs had their own chief financial officers and ran basically their own operations.

Just as a point of context on the CFO Act, and I was involved in the development of this act over about a decade, one of the most contentious issues was the requirement for audited financial statements. What the law says is for all business-type activities, trust fund, revolving funds, and commercial functions, you will prepare financial statements, you will have those audited. And there is like 160-something of those.

For an entity as a whole, whether it be the Army, IRS, or Customs, the Congress put it on a test basis. And the issue was, can the financial community produce relevant, useful information, given that the focus has traditionally been on the cash-based budget. People look at the budget as being the financial report, and they are saying, "Gee, we are not really sure how these commercial type of statements can be useful."

What we see this moving toward, though, is what I call an accountability report. And I think 5 years out you will see a much different type of opinion on Customs' and IRS' statements, and you will see a much different type of financial statement that reports back in a context that is really relevant to the Congress and the public. And at this stage, people are really trying to prove and to show how these reports can be of use. And that is why you don't have as many audits today of these larger entities.

Mr. HORN. Right. I want to get to value behind the report in a moment, but let me ask one more hierarchical question. Did you talk to the Deputy Director of OMB for Management?

Mr. STEINHOFF. Oh, yes.

Mr. HORN. And the Controller?

Mr. STEINHOFF. Yes.

Mr. HORN. What, if anything, did they say as to guidance they had given revenue-producing agencies such as Customs? Have they done anything since the act was passed 3 years ago?

Mr. HOLLOWAY. When you say given guidance, OMB as part of the CFO Act was required to put out general guidance as to how to go about complying with the act. My experience in working with both IRS and Customs was that both of those agencies, and again they can better speak to this, were in regular contact with both OMB and Treasury during the evolution of their financial statements, as well as their efforts to comply with the act. So I believe there has been an interface between the two in terms of trying to seek out the best way to go about doing this.

Mr. HORN. See, my problem as a former executive in a governmental agency is that OMB and Treasury should be doing this early on so the legislative branch's arm, the GAO, does not go in and find all these things wrong. And I am just wondering why there isn't more action, more initiative in the executive branch, particularly when you have revenue producers. And you have pointed out some of the flaws there.

Do you have any feeling on that? Is it because they haven't filled these positions, as I note you did state in here. Is that still not filled?

Mr. CHAPIN. That is still not filled.

Mr. HORN. How fast were they filled in the previous administration?

Mr. CHAPIN. Well, there was a similar degree of slowness in responding to the act and its requirements for CFO's. There is always a lot of discussion about the qualifications of people that come up for these appointments. Some of them, as you know, are confirmed appointees. But we are disappointed, very disappointed, that as yet there is no Controller, CFO Controller at OMB, and it has been months. And at roughly half the major agencies, a CFO has not yet been appointed. Without this kind of leadership, you can't go very far.

Fortunately, at Customs we have got people in place that are doing something. And you are going to see results from that. But if we don't have leadership in place out there in the agencies that can drive this process of financial management improvement, it is not going to happen.

Mr. HORN. Yes, I think the problem with OMB, as you well know, and BOB before it, where there was an Assistant Director for Management, is management just doesn't get the attention of the Director who is driven, his time is driven by the budget. Do you see any change in that corporate culture over there?

Mr. CHAPIN. Some, yes.

Mr. HORN. Is it for the better or worse?

Mr. CHAPIN. When you look at what has been done, the previous Controller at OMB, made a major effort to get things improved across government. In areas such as cash management and debt collection, there has been an effort made. It has had a substantial impact, but not near the impact it could have if there were more resources, more effort put on it. And this absence of people in place at this late date has certainly caused the effort to tail off. We can't afford to wait for people to be nominated to continue this process.

Mr. HORN. Go ahead.

Mr. STEINHOFF. One of the real thrusts of the CFO Act was to put the M in OMB and a deputy for management position at executive level two was established. A very qualified person, Frank Hodsoll, was first in that role. Phil Lader, who is spearheading a lot of the NPR work, is now in that role and brings a wealth of experience to the job. So I think the visibility and position have been raised a lot. The Controller, as Mr. Chapin said, did some outstanding work. But we are in a period now where we are waiting for some of the appointees to come in.

I am hopeful myself that we are seeing a much more higher qualification standard being applied and that we will have the right people in place in CFO jobs. But for these type of changes, where you are changing, really, the culture of some of these agencies, the drive has to come from the top; that is, the President on down to the department heads. And the CFO has to be someone who is really in that inner circle and really involved in the decisionmaking day to day.

Mr. HORN. Let me ask two more points, Mr. Chairman, if I might. Electronic data processing, you cited numerous examples of documents missing in the file to correctly put value on this and to followup, to gain revenue. Would a sensible, and I realize that is a value-laden word, electronic data process within Customs help al-

leviate some of those problems? And to what degree have they sought such a process?

Often Congress is so overwhelmed by the cost of these processes that we are derelict in not funding them. Has Customs thought this process through and made recommendations to OMB and thus to the President and to us?

Mr. CHAPIN. I am going to let my colleagues fill in, but the revenue system that is in place now, to help administer the trade laws and deal with all these pieces of paper, is essentially an electronic EDP-oriented system. It has had some beneficial results in speeding the trade flow. We have been critical of it because it hasn't had all the controls that it should have. But Customs is moving ahead with that.

I think the bill that was referred to before would require a more complete system. Certainly lots more can be done. This is all in line with the Vice President's initiative and the NPR initiatives to use electronic data processing to deal with the tremendous number of pieces of paper that this government is bogged down with.

If we can get to the point where we are dealing not only with the public, but also between agencies on an EDP basis, it should reduce some of the needs for people and some of the inefficiencies. These are some of the beneficial effects that will come out of that. But this government has a long way to go. We just don't have across government the kinds of systems that we should have.

If you were to compare our government to the private sector, you would see horrendous differences in the capability of the government to process data, process information, and process it accurately. We have got a lot to do.

Mr. HORN. Will GAO make strong recommendations in those particular areas?

Mr. CHAPIN. Yes, we will. We have recognized the need to do something more than talk about this issue on an agency basis. It seems to us the time has come for the government as a whole to try to assist the agencies in getting these systems up to date. We have got 23 major agencies. It seems to me that it makes a lot of sense with the common systems requirements to have some common approach to many of these issues. It is not only costly, but ineffective to have each agency trying to figure out how they should report at the agency level to the Congress and to the OMB.

We can provide a lot of help at the top of government if we can get the Treasury and OMB and the private sector to work together to bring the systems capability to the agencies.

Mr. HORN. Last question has to do with the value on the number that is put on the forms by Customs, the degree to which you are satisfied with the process. Let's take exports to a country X, and American goods, let's say capital goods, are sent there to aid in the manufacture of other things. Do you have any faith as to the value of that number? Because later, manufactured goods will be produced, might be circulated within X country. They might come back to the United States. The components argument in NAFTA and Mexico might be one example. To what degree should we have some confidence in what those numbers are?

Mr. HOLLOWAY. I think you should hope and seek to have a very high degree of confidence in it. I think that gets at some of the im-

portant issues about designing an EDP system. To go back to the specific question of Customs' EDP processes, I think you have a couple of fundamental things that hurt it. Then to get specifically to the question you asked, is that many of the systems are not integrated. In other words, one system does not talk to another so that they are not connected in such a way as to minimize the opportunities for something to go astray. I think one of the big efforts in the ACS, which is their primary revenue system, is the need to make sure that all the modules within that system are integrated in such a way that even within Customs, forget about interfacing with other agencies and other people, but just within Customs, that they are all talking to each other.

I think the second problem is that in the evolution of their systems, their revenue system was not designed to capture data in such a way that allows you to manipulate and track data. What it basically was designed to do, or seems to be designed to do, is to support the program function that just empirically says this is how much of something that happened. But to be able to go in and manipulate that data, to make various cuts at that data in a timely manner, it is difficult.

They have ways of doing it with special requests and in certain places like quota and some other places, but for the most part to just literally go in and to try to identify how much of what went where and by different breaks is very difficult to do in their current system because it is not an interactive file to just let you go in and grab things as you might want to define them. So, that is part of the problem.

And I think that as you move out and start talking about modernization and doing things to enhance the systems, and this is what I think Don was alluding to, you need to look at the big picture in order to make sure all the pieces are fitting together. Because in an agency like Customs where it overlaps with so many other agencies like INS and Commerce, I think the need to have those kind of proper interfaces is critical.

Even when you start talking about tracking things that are exported and imported back into this country, a great part of Customs' effort is focused on imports. A lot of it is not focused on exports. While they do some things with exports, their greater focus is on imports. I think that you have to correlate all of the different government organizations that have to be part of that puzzle as you design those systems to make sure that they interact the way that they need to.

Mr. SPRATT. Mr. Green.

Mr. GREEN. Thank you, Mr. Chairman. I will be brief. The GAO report mentions that there is no tracking method for guns or drugs or things like that. Were there any examples that showed that maybe the guns that were seized, or harder, I am sure, with drugs that were seized, ended up on the streets of the United States or maybe back in the country?

Mr. HOLLOWAY. In terms of carrying that all the way out, to try to be able to specifically identify that a particular drug was then found later on the street, would be kind of difficult to do. What we did find, though, is instances, and one in particular sticks in my mind, where there was, and I forget, I believe it was marijuana,

where there was a difference between what was recorded and what was actually on hand of almost 2,000 pounds.

Well, one could argue, did that get back on the streets? Did somebody else take it and use it or what happened to it?

Mr. GREEN. Or did it dry out?

Mr. HOLLOWAY. Or did it dry out? I mean there is any number of reasons, but the problem that we had is that the things possibly were not weighed accurately when they first came in, because sometimes they just make ballpark estimates. But when you are dealing with something that is as sensitive as drugs are and as big a problem in this country as drugs are, I think that kind of emphasis needs to be applied in securing those drugs and making sure that they are properly accounted for. And we found instances where that just wasn't occurring, whether it was in the form of not always weighing things, or whether it was in the form of the physical security around the drugs once they were in Customs' possession, including access to the vault by an unaccompanied custodian.

If you look at most financial institutions, there is a significant emphasis on security and accountability. An example, and a good analogy, would be the ATM system. I mean all of us use ATM's. Basically an ATM is a machine loaded with money.

Well, in most banks that are responsible, no one person can go to that ATM by themselves. There is always at least two to assure the money is secured and accounted for. Well, I think drugs have that same kind of serious atmosphere about them as well, and I think that it is just those kinds of fundamental procedures that we found weren't always being followed. And I think there is a need for that.

There were no video cameras that just routinely monitored the vaults where drugs and weapons were being kept. I mean just fundamental kinds of things that need to be in place.

Mr. GREEN. OK. I know it is harder to trace drugs, but guns, unless the serial numbers are off of them, were there examples that the GAO found of guns ending up on the street?

Mr. HOLLOWAY. We didn't find any examples, but I guess I would say in fairness to that, we didn't go out and try to pin down the source of those kinds of things.

Mr. STEINHOFF. There are cases, as I understand it, where Customs, through its own internal investigatory processes, has prosecuted some of its own employees for stealing drugs. Now, those are ones Customs found. Whether there were others that stole drugs they didn't find, I don't know. But there are cases where people have been prosecuted for stealing drugs.

Mr. GREEN. I share Congressman Horn's and the chairman's concern, and I am talking about different issues. One of them is the transshipment, that we haven't discussed yet with the GAO. Do you feel like the provisions that penalize the U.S. companies are strong enough? I know we are dealing with treaties and trade with other countries, but the companies are actually importing the merchandise.

Did your study show that the penalties for our own companies or our own brokers, maybe, are strong enough?

Mr. HOLLOWAY. I think what we find is that the penalties in the law are certainly strong enough. Where the issue comes in is what

happens in the mitigation process and the reduction of those penalties to what finally gets charged. Does the law provide penalties that are pretty severe? Absolutely. But in terms of how is that getting practically implemented, that is one of the things that as part of our second-year audit of Customs we are looking more closely at. We will review the whole mitigation process.

For example, one of the things we talk about is the fact that Customs reported over a 2-year period that they had made about \$7.9 billion in assessments. That is a lot of assessments.

Now, there is a multitude of reasons for why that number is that high that range anywhere from overassessments based on what was actually subsequently found to be supportable to the mitigation process itself. So it is a two-edged sword. I mean you got to have the legal things that you can charge, but you also have to enforce them at those levels. And for whatever reason, and as I said there is a multitude of them, that is not happening.

Mr. GREEN. OK. So again, assessments are much higher than whatever we actually collect?

Mr. HOLLOWAY. That is what we see.

Mr. GREEN. The big concern I have had, and I had a number of constituents who have called our office, they may go to a department store and see XYZ shirt. It may have a Malaysia tag on it, it may have a Sri Lanka, it may have a People's Republic of China, or Guatemala. And what you are saying is that particular apparel could all have been made in one location, and just had the tags sewed on in those particular countries?

Mr. HOLLOWAY. Certainly that is conceivable.

Mr. GREEN. Thank you, Mr. Chairman.

Mr. SPRATT. Thank you, Mr. Green. Mr. Chapin, Mr. Holloway, and Mr. Steinhoff, thank you very much. We hope you will come back next year. We will follow this up, and we hope by then you will be able at least to render a qualified certificate as to the financial statements rendered by the Customs Service.

Thank you again for your testimony and for your time.

Mr. CHAPIN. We share that hope and thank you, Mr. Chairman.

Mr. SPRATT. Our next panel will begin with the Customs Service itself, and the principal witness is Mr. Sam Banks.

Mr. Banks, thank you very much for coming this morning. We welcome you. You have also prefled your testimony. As a matter of course, we will make it part of the record. If there is no objection, you can summarize. Proceed as you please. The floor is yours.

STATEMENT OF SAMUEL H. BANKS, ACTING DEPUTY COMMISSIONER, U.S. CUSTOMS SERVICE

Mr. BANKS. Thank you, Mr. Chairman, and I will try to be brief. Basically, we are here to testify on our implementation of the CFO legislation, on textile transshipment, and to briefly discuss the National Performance Review.

On the CFO legislation, as you heard from GAO, Customs has launched a major initiative. We have allocated a lot of priority attention and a lot of priority time and resources in order to try to redress the issues that were identified as a result of that legislation. I think we have made a lot of progress, but I think like all the other agencies that are involved in this thing, this isn't going

to be easy. It is going to be a multiyear effort. It is going to take a lot of energy on our parts.

In October 1992, we finally introduced a new core financial system, an automated financial system. We are in the process of integrating all our accounts receivable with our revenue side. In fact, we are in the process of integrating a lot of our systems in order to address the concerns that have been raised by GAO.

We have redone our physical inventory systems. In fact, we are trying to integrate that into all of our financial structures as well. We have been working, even preceding the CFO legislation, on our FMFIA internal control issues, and again, that is a major issue for integration within all of these financial automation systems.

On the seized property program, we have completely revamped that. We have got several new automated systems that are supposed to go online at the turn of the year to address these issues, and GAO has at least signed off on the design specs for those programs. And last, is on our budget system, and again it is mainly to try to integrate your budget process.

We have actually provided, in addition to my statement, some previous testimony that we had on all of the technical aspects that we have done as far as CFO legislation, and I would just like to have that for the record, if that is possible.

The other thing that was mentioned by the GAO had to do with the general management review that they did. They brought in a whole bunch of people for a significant period of time and went through us top to bottom, and they came back and said that we couldn't guarantee them a certain compliance level on our examinations. Well, we have redesigned our approach so that we have got a statistically based, sound way of establishing what the compliance rates are for specific commodities, for specific countries, and even in specific port areas where we are operating. We are really in kind of a test approach on that thing. Again, that is going to be a multiyear effort because it is a very big enterprise to take this on.

On textile transshipment, I would say to you that has been and is a major priority. It is our No. 1 priority under our trade enforcement strategy. It has not been easy to control, as all of you are aware. The old ways of doing business, where you sit on a dock or you sit at a land border and you inspect the goods that come in, don't address textile transshipment totally.

In fact, it just barely addresses the current way that we handle imports. We use document reviews and question that, and compare it against other things. Old methods do not work to attack textile transshipment. We have had to go in and devise completely new ways to approach this that are radically different. We are not on our borders anymore, we are actually sending people overseas.

We are going into factories all over the world in order to verify their production capabilities of specific commodities. We have been in over 30 countries, and, depending on how you count it, almost 800 factories that we have been in. And this has probably been the single, most effective means we have had to address transshipment, though we have also got our foreign offices that are focusing in on this.

Using PC's and distributive processing, we are establishing automated baselines so we can see when we get fluctuations in certain companies, in certain products, so we can focus our resources on that. Our resource, just throwing resources at this issue, has been a big, you know, a big enterprise.

You know about the investigation that we had, especially on the Q-TIP operation, that we think is at least somewhat successful. And we built a lot of automated systems to address these issues. Probably the most recent one that we are trying to bring online, not so much to address transshipment, but to address counterfeit visas, textile visas, is our ELVIS system, our electronic visa system.

I would say, if you are asking us what we need to address this textile transshipment issue, we are not up here to ask you for more resources at this point. We want to try to refocus our resources, re-adjust our resources.

What we do need is, one, we need the authority to go into these countries, these transshipment points, and look at those factories. We need the authority to get in there to do audits. And I would say we have that under NAFTA. That is one of the main things that we negotiated under NAFTA, to get the authority to go in, to send auditors, to send production or trade experts in to find out what they are doing in their plants and to review the records. That is what we need and USTR and CITA are working very hard in order to try to get us that authority, but that is a key point.

I think that one of the other things that we look forward to is the textile transshipment task force headed by Jennifer Hillman and Rita Hayes. There are a lot of things that we are looking at, new proposals, adjusting the penalty processes, coming up with new systems for information exchange, not only within the U.S. Government, but also internationally.

We are looking at new specialized teams that would be taken away from their normal functions, routine functions, and put specifically dedicated toward this effort. One of the other things that you heard was H.R. 11. If there is one thing that we really need Congress to give us, is to lift us from 200 years of archaic legislation that just bogs us down behind mounds of paper. It handcuffs our officers to the desks instead of being able to go out and review the importer's premises and being able to go into these factories.

You talk about reinvention. Well, we can't reinvent anything until we get the legislation, you know, relief from these old archaic requirements—like a master of a vessel has to report how many cannon and shot they have on board their vessels when they arrive. It is unbelievable. You know, you talk about private industry doesn't operate this way. Well, private industry doesn't have these constraints laid on them.

You heard about us trying to reorganize the Customs Service in response to the National Performance Review. Well, it has only been in the last few months that we finally got lifted a congressional restriction that says you may not even study a plan to close any offices. Well, if industry had to live with that, it is very difficult to do.

Finally, we have been successful. The Congress has decided to lift that. The Deputy Commissioner has been dedicated to a 6-

month task force, not just to reorganize the Customs Service, but to reengineer the U.S. Customs Service. So that effort is under way under the National Performance Review. And I guess that is what I would say as far as the National Performance Review issue, it is really just this Modernization Act, the H.R. 700, and the internal reorganization. And with that I will conclude my formal statement, Mr. Chairman.

[The prepared statement of Mr. Banks follows:]

Statement of Samuel H. Banks
Acting Deputy Commissioner of Customs
In Presentation to the
House Subcommittee on Commerce,
Consumer and Monetary Affairs
October 5, 1993

Mr. Chairman and Members of the Subcommittee, it is a pleasure to appear this morning to discuss Customs implementation of the Chief Financial Officers (CFO) Act, and the problem of illegally transshipping textiles and apparel into our domestic market.

The Chief Financial Officers Act is important legislation for many reasons, but it is especially relevant to the Administration's current effort to "reinvent government." Customs is committed to ensuring full compliance with the Act, especially to the goal of providing the Administration, the Congress, and the public with accurate and reliable financial reports. While it is clear that it will require further efforts by Customs to achieve compliance with CFO requirements, we will continue to dedicate priority attention and resources to fully implement this legislation.

To this end, Customs has established a series of highly complex programs to meet GAO recommendations and the CFO objectives for Customs financial, accounting, and property systems. A full discussion of these technical issues and the current implementation status is submitted with this statement.

The second issue, illegal textile and apparel transshipments, is clearly a major import problem for the Customs Service. Although, from Customs standpoint, we have no direct

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knowledge of annual job losses to these illegal imports, we do recognize the serious inroads it has produced in domestic industry. The amount of these goods entering our domestic commerce is substantial and of great concern to us, and we believe it is a growing problem.

At the Customs Service, our top trade enforcement priorities is the enforcement of our trade agreements and the aggressive pursuit of illegally transshipped merchandise. Our import specialists, auditors, inspectors, and special agents are attempting to fully enforce all quota and visa bilateral textile agreements to the "letter of the law." Despite our shifting of many resources and capabilities to the illegal transshipments, the problem has proven hard to control because of the inherent difficulties in identifying these goods. Our initial inspections can usually only pinpoint the most glaring instances of transshipped goods. As violators become more sophisticated, which is nowadays the prevalent situation, merely looking at the merchandise and/or casually perusing the documents is insufficient to identify such merchandise. Tracing goods back to their origin with a documented paper trail is no simple task when there has been a concerted coverup by all involved commercial parties in several countries.

There have been some notable successes as a result of the new approaches adopted by the Customs Service. A most useful program has been the textile production verification teams, or Jump Teams." Composed of import specialists and investigators,

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they are sort of "rapid response" teams dispatched to the foreign factories supposedly producing suspected imports. These teams have inspected hundreds of factories in 30 countries and have significantly deterred numerous illegal activities.

Customs has harnessed many of its capabilities in this tough battle to discourage illegal textile and apparel imports. All of our foreign offices now participate in the program. Once an import is suspect, it is referred to a foreign Customs Attache Office for intensive investigation at the export site. Our inspections and review of incoming cargo and its related documents have been beefed up as much as possible. Inspectors and Import Specialists have been formed into working teams to seek physical evidence of transshipment. Customs Import Specialists involved in this activity are expert in textile production worldwide and import documentary evidence.

In support of the on-site inspection and analysis of the cargo and its documentation, Customs is working on developing an automated system for analyzing trade and transshipment patterns to pinpoint potential illegal activities. An initial step in developing this capability is the upgrading of our import statistics. Customs is attempting to assure the accuracy of these statistics by implementing improved importer compliance and the targeting of cargo inspections. Furthermore, the Customs Modernization and Informed Compliance Act will assist in this effort by placing responsibility for accurate declarations squarely on the importer. More accurate trade statistics will

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extend our ability to analyze trade patterns and trends.

As an example, our framework for analyzing Mexican imports incorporates a preliminary statistical baseline of key importers and manufacturers. Ultimately, the system will be extended to provide "early warning" signals for possible shifts in traditional import patterns, which in turn will trigger inspection blitzes of specific goods, countries, or import transactions.

Customs is also harnessing the capabilities of its automated system in our attempt to thwart illegal imports. We are developing statistical targeting schemes derived from randomly sampled entries. These analytical techniques will be incorporated into the Customs Automated Commercial System (ACS). An exciting new extension of our selective targeting program is threat analyses of countries suspected of textile and apparel transshipment.

Customs is undertaking all of these intensive efforts by shifting and concentrating limited resources to this priority program. In anticipation of the growing trade with Mexico, which has increased substantially since 1989, we have allocated some added resources and have implemented many of these new initiatives. As trade continues to increase, especially under a NAFTA, Customs will become more dependent upon highly selective inspectional and analytic methods. Verification Teams will be used to verify production capabilities of suspect textile exporters in Mexico. These teams will become the mainstay of our

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efforts to deter illegal exports.

Our experience indicates that current and developing programs will improve our overall efforts against illegal textile and apparel transshipment. The recent Operation Q-TIP demonstrated our ability to prosecute and convict illegal operators. We believe that certain specific actions, such as increased penalties, better data, more specific information on foreign manufacturers, and expedited judicial action, will greatly assist our efforts against worldwide illegal textile and apparel activities. However our efforts must be tailored to available resources and to the requirements of servicing imports rapidly and efficiently. We believe, enacting the "Mod Act", which is supported by the National Performance Review, will give Customs the flexibility to allocate its resources most efficiently to meet identified priority problems.

One of the other encouraging efforts is the improved cooperation and support of the Committee for the Implementation of Textile Agreements (CITA) and the U.S. Trade Representative's Office. We are pleased to participate in the Transshipment Task Force. We have also gotten tremendous support and intelligence from U.S. textile manufacturers.

The final issue you wished to explore is the implementation of Vice President Gore's National Performance Review (NPR) at the Customs Service. In our view, I can assure you, the NPR presents a much needed fresh approach to improving government operations. Implementing its ideas, concepts and proposals will assure

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responsive, efficient, and effective government. We are fully committed to doing our part.

Commissioner Weise has chartered a reorganization study team to thoroughly review Customs organizational structure and its operational and processing systems. We intend to fully consider the NPR proposals, particularly its cost-cutting improvements, in the final study. The reality of future Customs Operations conducted with diminished resources makes it imperative to strive for more efficient and effective way of doing business. At Customs, we are looking forward to the challenge.

Mr. Chairman, this concludes my formal statement. At this time, I would be pleased to answer questions of the Subcommittee.

CHIEF FINANCIAL OFFICER'S (CFO) ACT
AT THE CUSTOMS SERVICE

While it is clear that it will take some time for Customs to achieve full compliance with the CFO Act, Customs has and will continue to dedicate sufficient resources to implement this legislation. For example, while full integration of all ancillary systems may take more than two years, Customs took the initiative and installed a new core financial system in October 1992. As additional enhancements are developed, they too will be implemented in accordance with the objectives of the CFO Act. In addition, Customs will continue in its partnership with GAO to ensure that the statements are adequately supported by competent data and that automated systems include appropriate controls to guarantee reliable and accurate statements.

Congress passed the Chief Financial Officer's Act in 1990 in response to long-standing financial management accountability and control problems that had plagued the Federal Government for many years. Customs was required by the Act to prepare and submit audited financial statements for fiscal years 1992 and 1993 as part of the "pilot project" detailed in the legislation. As authorized by the Act, the General Accounting Office determined it would conduct the required audits of these statements.

In order to meet the intent of the Act, and become a model agency insofar as the implementation of the Act was concerned, Customs and the Department solicited the assistance of the

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General Accounting Office. The Comptroller General concurred, and provided a staff to work with Customs. As a result of GAO's preliminary work, Customs developed a comprehensive plan to review and analyze various accounting issues including revenue recognition, receivables, uncollectibles, fixed asset inventories, and seized and forfeited property. With the assistance of OMB and Treasury, Customs also developed pro forma financial statements with the assistance of OMB and Treasury.

For many years, Customs had not focused on financial issues. As a result, systems had been implemented to accommodate operations, but these systems did not always include sufficient internal controls and accounting requirements. This oversight led to numerous questions generated by the Federal Managers' Financial Integrity Act (FMFIA), and continued congressional concern about the degree of control Customs was able to impose on its own financial management. These same inadequate systems, lacking sufficient internal controls and accounting requirements, caused difficulty for Customs when the time came to prepare auditable financial statements.

Since mid 1989, Customs also has significantly enhanced its financial management organization and activities. A task force was established that addressed all outstanding FMFIA issues and

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this task force reported its progress regularly to the Department. Customs established measurable, concrete plans, and slippage was rarely permitted.

As a result of FMFIA issues and other financial issues, in 1990, Customs prepared a financial management plan to capture and assign responsibility for corrective actions Customs viewed as necessary to improve its financial management activities. To ensure continuing progress, Customs Chief Financial Officer holds regular meetings with individuals across all disciplines tasked to implement those improvements to ensure continued progress.

It also became clear that for many years, Customs had been unable to reconcile its collections and deposits and its appropriated funds balances with Treasury. After a very laborious process of reviewing documents, enhancing systems, and working with GAO and Treasury, Customs was able to correct this situation, and first succeeded in reconciling its collections and deposits for the month of December 1989. Since then, Customs collections and deposits have remained reconciled except for four unexplained differences which have been resolved and one that is currently being evaluated. Moreover, Customs has also,

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- one, reconciled long outstanding differences between collections and deposits prior to December 1989 with the assistance of GAO,
- two, instituted Treasury's new Cash Link program that enables Customs to reconcile collections and deposits daily,
- three, reconciled Fiscal Year 1989 and subsequent Fiscal Year cash accounts with Treasury, and
- finally, reconciled all prior year cash accounts with Treasury in 1991 and continued to reconcile cash accounts on a monthly basis.

In addition, Customs implemented fund controls in late 1989 to accommodate funding constraints imposed by continuing resolutions, and in fiscal year 1992 Customs reduced interest costs, when compared to the figures for FY 89, by about \$200,000.

To prevent duplicate payments, Customs took steps to improve disbursement procedures in the area of manual and systems controls, and these procedures have been expanded to the new core accounting system implemented in FY 93. In addition to the

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incorporation of edit checks in the system, an internal review of all disbursements is also conducted now to help identify and resolve potential duplicate payments.

As the result of the first required audit of the Customs Forfeiture Fund, which resulted in no opinion from the auditors, improvements were made to perpetual and physical inventory controls and records. Accruals were also established at year-end for the Fund. In response to these improvements, independent auditors concluded the financial statements for Fiscal Years 1991 and 1992 were presented fairly. GAO worked closely with Customs to design the statements and review the auditor's reports before issuance to Congress.

Customs also began to monitor and provide its managers with various reports that demonstrated the need for improvements in certain financial areas. For example, Customs imprest fund errors were excessive, but by June 1992, the error rate on imprest fund subvouchers was less than 5 percent, or 4 percent below the expected error rate for FY 1992.

In December 1990, Customs began to develop a series of Management Information Reports, which included what have become known as "Red Flag" reports. These reports are designed to provide Customs field managers with basic information on cost,

quality, and service of operational programs at the district level. Very importantly, the "Red Flag" portion of these reports will not only demonstrate performance against national averages (or thresholds), but will also point out areas where deficiencies in program performance exist.

On yet another front, travel advances were substantiated in Fiscal Year 1991, and more than \$3.2 million of outstanding advances were resolved. New, aggressive procedures were implemented to seek out delinquent advances and resolve them with the travelers.

Throughout GAO's audit effort, Customs learned a number of important lessons. For example, GAO reinforced the notion that planned enhancements to systems such as revenue were warranted to comply with acceptable accounting principles. Also, it became clear that there was a need for compliance with established policies and procedures, and that the disclosure of various accounting issues had to be resolved.

In 1993, Customs continues to be committed to enhancing its financial management activities. Current Customs efforts include:

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- implementing an integrated new core accounting system with subsidiary systems that provide supporting data for the core system.
- enhancing revenue and receivables systems to properly recognize revenue and enhancing monitoring and collection of outstanding receivables.
- emphasizing and testing compliance with established policies and procedures to control Customs and custodial assets and liabilities.

Customs recognizes that much has already been done to enhance financial management and that plans are in place to afford further improvements. Even so, we believe that there is more to be done. Our goal in this regard is to be a model agency for the entire federal government, and to produce accurate and reliable financial statements that warrant a "clean," unqualified opinion from the auditors. Although such an opinion may not be obtainable for several years, you have my assurance that Customs is committed to realizing the goals articulated in the CFO Act, and to working cooperatively with GAO, OMB, and Treasury to meet those goals.

PROPERTY

Customs attempted to reconcile its perpetual inventory records with its fixed assets accountability system for FY 1990 through FY 1992, and conducted a physical inventory of the inventory in August 1992. Customs was unable to completely reconcile the fixed asset general ledger accounts to detail property subsidiary records due to significant resources which would have been required to reconcile pre-1990 property activity.

Currently, any purchase which is assigned a budget object class 31 (Equipment) is posted in the general ledger accounts for property and equipment. However, much of this equipment does not meet the capitalization criteria and should be posted to an expense account. In other words, much of the equipment cost less than \$5,000 or has an estimated useful life of less than two years.

There are also situations where equipment is acquired through budget object class 23 (Rent, communication, and utilities). Specifically, certain equipment lease payments for agreements which meet the criteria for a capital lease, per GAO's Title 2, are paid through budget object class 23 and should be recorded as fixed assets on the general ledger. Currently,

however, the leased equipment is recorded in the subsidiary property system, while the payment is charged to an expense account on the general ledger.

In addition, Customs policy on the budget classification assignment criteria was not clearly defined for service contracts. Many of Customs service contracts result in the acquisition of property or equipment. However, according to the former policy directive, these expenditures would be charged to budget object class 25 (Other Services). This policy directive was rewritten and issued on March 11, 1993. This revised policy directive clearly states that budget object class 25 "...Excludes any obligation which results in the procurement of equipment which is charged to object class 31." We believe this revised budget classification policy directive will help minimize the differences which occur between the general ledger and the property subsidiary systems.

For many years, Customs fixed asset account posting has been driven by budget object class code. Until FY 1991, there was no effort to reconcile the system due to personnel and funding constraints. By 1991, there were so many discrepancies between the systems, it was not economically feasible to reconcile all entries in the general ledger, which were valued at less than the capitalization threshold (\$5,000). Instead, it was decided to

concentrate resources on entries in the general ledger of \$5,000 or greater for FY 90, 91 and 92 with budget object class 31, and to adjust the subsidiary property system accordingly. Given the large number of errors from past years and the volume of data which had to be analyzed, this methodology was the most feasible. Both GAO and the Department agreed on the change in capitalization criteria.

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In addition, the data entry function for property and equipment has been centralized at the National Logistics Center so inputs to the system can be controlled. A Quality Assistance program has been developed to help identify and eliminate problems which property management personnel are experiencing. Inventory procedures have been revised to help identify unrecorded assets, and we have developed enhancements to the property subsidiary system which should provide long-term solutions.

During FY 92, Customs performed a physical inventory of all personal property items with an acquisition value of \$5,000 or greater and a sample of all other personal property items of lesser value. Real property, real property improvements and computer software were excluded from these procedures because they were never recorded in the subsidiary property management system in the past.

Customs is in the process of developing procedures that will allow for a physical inventory of all real property and related improvements. These procedures allow for an inventory of all Customs owned buildings as well as for major improvements to leased buildings. In the event that the procedures are not completed by September 30, 1993, the physical inventory will be performed as soon as the procedures are completed; this will

enable us to conduct an inventory before issuance of the 1993 statements. In addition, personnel are currently being trained as Certified Real Estate Appraisers. Once certified, they will be better equipped to assess the values of Customs owned real property.

In the past, Customs had not recorded mainframe software in the subsidiary property system, contrary to GAO's Title 2. Customs is currently in the process of developing procedures to identify and capitalize all mainframe computer software which meets the capitalization criteria and to record it in the subsidiary property system. Once recorded in the subsidiary property system, these items will be inventoried as part of the annual physical inventory of personal property.

In addition, Customs has revised its procedures for the physical inventory of personal property for FY 93. These revised procedures will provide a more comprehensive inventory, including assurance that all capital equipment items in the possession of Customs are recorded in the subsidiary property system. We expect to achieve this by providing more detailed instructions on selecting a sample of capital equipment items on hand, and tracing back to the subsidiary records to ensure that the items are recorded. In addition, these procedures will provide for a more adequate separation of duties during the inventory process.

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As part of the advance planning for the 1993 inventory, Customs has been working with GAO to ensure that the procedures are adequate. On July 16, 1993, GAO concurred that Customs physical inventory procedures for 1993 were adequate.

The cost of the 706 items selected in GAO's sample of property items totalled approximately \$550 million. The cost of the items for which support could not be provided totalled \$9 million. Therefore, purchase documentation could not be provided for assets with a cost totalling 1.63 percent of the total sample. However, many of the property items for which Customs could not provide supporting documentation were acquired prior to 1990. With GAO's assistance, Customs plans to develop a methodology to determine acquisition values for items for which supporting documents could not be found.

The 735 items which GAO states "appear to be estimates," are those items in the property subsidiary system recorded with even dollar amounts in the cost field. That is, the cost is \$5,000; \$10,000; \$15,000, etc. These items will be examined to determine if the costs are estimates, and if the estimates are valid.

FINANCIAL STATEMENT PRESENTATION

As a result of Customs efforts with OMB, GAO and the Department, Customs financial statements for fiscal year 1992 differ from certain OMB guidelines, but these deviations provide a more meaningful presentation for the users of the data. For example, depreciation, an unfunded expense, is not shown as a reduction to property and equipment because it is not useful in determining when to make replacement purchases. In private business such an expense requires the establishment of a reserve against income, an option which is not afforded to Customs in its budget authority. Therefore, the fiscal year 1992 statements show, based on 1992 replacement data and expected useful life of the various classifications of Customs property and equipment, the projected capital outlay expenditures in future years. Such information is essential for budget planning purposes.

In addition, OMB guidance states Seized Property should be shown at the net realizable value in the financial statements. Although Customs does have a fiduciary responsibility for seized assets, such assets are not owned by Customs until forfeited. However, due to the significance of the estimated value of seized

property in Customs care, a caption for seized property was shown on the Statement of Financial Position with no amount and current year activity shown in the footnote.

FINANCIAL MANAGEMENT STRUCTURE

Customs has made several significant changes to its financial management structure. These include:

1. designation of a CFO and Deputy CFO;
2. assignment of all Customs Service functional responsibility for the collection and processing of Customs revenues to the Office of the Comptroller, i.e., Deputy CFO;
3. designation of the Financial Policy and Oversight Division in the Office of the Comptroller as the focal point for overall policy coordination and program analysis of financial management operations;

4. creation of the AIMS Division within the Office of the Comptroller to direct and support the development and implementation of Customs new automated financial management system, the Asset Information Management System (AIMS); and
5. creation of a Management Controls Division to direct and oversee the implementation of the Federal Managers' Financial Integrity Act (FMFIA) and the management controls review process in Customs.

BASIS FOR 1992 STATEMENTS AND SYSTEMS ENHANCEMENTS

In the past, Customs annual reports were generally prepared on a cash basis, but with the preparation of auditable financial statements for FY 1992 and beyond, Customs developed policies and procedures to present its financial operations on the accrual basis of accounting.

Unfortunately, Customs accounting system did not have the capability to conform to proper accrual accounting practices as required by CFO financial reporting. In response, Customs developed manual procedures to meet these reporting requirements for the immediate future, and in cases where these accrual

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requirements can be met in the long term, the new core accounting system installed in October 1992 will provide the proper reporting. In cases where continued manual accruals are dictated, appropriate procedures will be institutionalized.

Customs has initiated a broad based project to improve the quality and effectiveness of financial management, accounting and budgeting systems, practices and procedures. The project is known as AIMS, the Asset Information Management System, and it encompasses an integrated financial management system. AIMS will provide Customs with a financial system that will resolve FMFIA deficiencies and meet Joint Financial Management Improvement Program (JFMIP) Core Requirements and that will modernize and streamline Customs administrative systems and procedures.

The objective of the AIMS project is two-fold:

- (1) to implement a modern financial system which corrects current deficiencies and is in compliance with federal financial systems requirements, and
- (2) to integrate and upgrade ancillary administrative systems.

The first goal was met in Phase I of the AIMS project. A new core financial system was implemented on schedule, on October 1, 1992. The second goal will be met in Phase II of the project, which is now underway. Highlights of AIMS projects are presented in the following paragraphs.

After analyzing the options, Customs concluded to use off-the-shelf software for the core system. The Federal Financial System (FFS), developed by American Management Systems, was selected.

- This decision supports Customs, and the government's, goal of using off-the-shelf software to the fullest extent possible.
- FFS is fully compliant with JFMIP Core Financial System Requirements and GAO accounting requirements.
- FFS provides system generated external reports to meet Treasury and OMB requirements.
- FFS modernizes Customs processing by providing on-line edit and update.

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As a result of its involvement in the AIMS project, Customs recognized the need to place additional focus on reports from the new system.

- Customs developed an easy to use, automated reports system, known as the Reports Management System (RMS).
- RMS provides users with reliable and timely information from the system.
- Customs also developed requirements for all essential reports and implemented them in the first quarter of FY 1993.
- Finally, full automated and advanced capabilities are now being developed and will be implemented in FY 1994.

Customs will also be developing a cost accounting system, which it currently does not have.

- This new system will resolve a current, and long standing, FMFIA deficiency.
- As part of the new payroll system, a labor distribution system was developed and implemented in April 1992.

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- Off-the-shelf software (the FFS Project Cost Accounting System) will be used for project cost accounting. It provides project budgeting and costing, plus tracks reimbursable agreements, receivables, and obligations at the detail level. Customs plans to implement the project cost software on October 1, 1993.

- Cost accumulation and distribution requirements have been completed. A pilot test is scheduled for October 1993 in Puerto Rico and the Virgin Islands, two locations where Customs bills a third party for both direct and indirect costs incurred. At the conclusion of the test, plans will be developed to expand the cost accounting Customswide.

Customs will also improve the automated revenue programs and systems by redesigning and enhancing the financial aspects of the Automated Commercial System (ACS). The project, known as the Customs Automated Revenue Accounting (CARA) project, was initiated in the last quarter of FY 1992. Data gathering and analysis, and the preparation of user requirements, are now underway. This project will bring revenue systems into compliance with GAO, CFO and JFMIP requirements. It will also provide better control over Customs collections and receivables.

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In addition to the planned enhancements to existing accounting and ancillary systems, Customs converted to the Agriculture payroll system in April 1992, as part of Treasury's effort to standardize payroll operations and systems throughout the Department. The Treasury Payroll System (TPIS) was 17 years old at the time Treasury began a study in 1987, which indicated that it was outdated and that their staff was having difficulty in keeping current with all the legislative changes. Treasury therefore decided to convert all of its agencies to the USDA system by the end of 1992. U.S. Customs converted on April 19, 1992.

The new system has its drawbacks and benefits which include:

- The USDA system is programmed to default to the employee's duty station for state and local withholding which is not necessarily the state of residence. This was not the case with TPIS. As a result, there were errors in withholding during the first year. This has since been resolved, and we do not anticipate future problems in this area.

- Since we designed our own Time and Attendance (T&A) system mainly due to the 1911 Overtime for our inspectors, we encountered some unforeseen problems

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during the first year as we are the only agency serviced by USDA that did not adopt their T&A system. We have identified areas in the Time and Attendance Maintenance System (TAMS) that have caused problems with the interface with USDA, such as, (1) the 1911 Overtime information between TAMS and the USDA database. Certain fields dropped off in the transfer of data causing the employee to be underpaid. This has been corrected for current payments, and prior underpayments were paid manually; (2) corrected T&A's processed for leave purposes. Corrected T&A's do not update leave balances in TAMS but do properly update the USDA database. Therefore, the balances on the leave and earning statements are correct; and (3) military leave. Due to the fact that USDA tracks military leave on a calendar year basis when it is actually accrued on a fiscal year basis, Customs is having problems with the carryover balances, and in some instances, employees have been underpaid.

The problems have been identified, and our programmers are working to rectify them. Twenty-one original programming needs were identified. Ten have been completed, and the remaining 11 will be completed this year. Examples are:

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- o Updating of leave to master records for corrected T&A's.
 - o Development of a report that will track hours charged to union activity.
 - o Addition of an additional field for military leave carrying it forward in the master record.
 - o Development of an on-line report of corrected T&A's submitted each pay period.
- When corrections are processed either in the T&A system or personnel system to recover salary overpayments, bills are automatically generated and sent to affected employees. Their collection procedures adhere strictly to the regulations found in the Debt Collections Act.
- Under TPIS we were averaging 50-60 emergency payments per pay period; since conversion, it has decreased to about 5. In addition, we are aware of the need sooner, which enables us to ensure payment on payday. We were not always able to accomplish this under TPIS.

FINANCIAL MANAGERS' FINANCIAL INTEGRITY ACT PROCESS

Customs has established a comprehensive process under the Federal Managers' Financial Integrity Act to assure that material weaknesses and non-conformances with accounting standards are identified.

Over the last several years, Customs has progressively established a more comprehensive and focused FMFIA process, which has improved Customs capability to identify and analyze the significance of management control weaknesses, and to follow up to make sure they are eventually corrected. It has accomplished this by establishing a permanent organization to administer both the financial systems reviews required by FMFIA and the general management control reviews of all program areas required by FMFIA.

Customs has rendered the FMFIA effort more effective by creating a complete cycle of management monitoring, review, problem identification, analysis, planning for corrective action, and followup. Formerly, the results of different agency review processes or external audits were not always coordinated, or analyzed as part of one coherent review and decision making process. Our current FMFIA efforts include a comprehensive analysis of the findings of GAO and IG audits, FMFIA Section 2

Management Control reviews, internal program reviews of all types, or any other information relevant to management and control deficiencies. These findings are then channelled through a structured FMFIA and internal planning process to determine their significance and to decide how they should be addressed and corrected. Some of the major elements of this process are as follows.

The major procedures/controls for Customs major programs have been identified and documented. Customs has conducted risk assessments every three years since the inception of FMFIA to determine areas of our procedures/controls that warrant more intensive review. Program managers have been asked to conduct management control reviews of the adequacy of procedures/controls in their area at least once every three years (and more often if a high risk area) as part of their Management Control Plans. Any findings of deficiencies by managers are reported each year in our Annual FMFIA report process, which elicits information not only from management control reviews but from IG audits, GAO reviews, and other internal management reviews. The annual review process also considers the findings of FMFIA Section 4 reviews, under which the conformance of Customs major systems to GAO standards are evaluated on a three year cycle, which is itself designed to indicate how well procedures/controls are being implemented at working level. This national compliance

review process has recently been automated through a system called MCRS, allowing findings to be more widely available to Customs managers at all levels. The effectiveness of regional FMFIA programs is now examined through our cyclical reviews of these programs. Customs has also done considerable work in the last two years to create "red flag" or "early warning" reports, by which indicators in our data systems provide early warning of problems or deficiencies to managers. A new system called CMITS will soon record and permit comprehensive tracking of the findings and recommendations of all internal and external reviews of Customs operations.

The important point to note is that all of these review processes, initiatives, and systems have been or are being created to assure that all control deficiencies (or potential deficiencies) will be identified, recognized, and addressed through one of the elements of our total management controls structure. Although some of the elements of this approach are still relatively new, the effective operation of all the review and evaluation parts of this program makes it increasingly unlikely that a significant deficiency will remain undetected and unaddressed for any length of time.

Once identified, deficiencies are evaluated by Customs managers in an explicit process to determine which deficiencies should be reported to the President and Congress as material weaknesses under FMFIA, and which deficiencies should be dealt with through normal management processes. Specific criteria have been established under FMFIA for a determination of the "material" versus "non-material" status of a deficiency. These include the scope and extent of impact on agency resources, prevalence of the problem throughout all agency operations or locations, threat to mission accomplishment, and other factors. To some extent these criteria are judgmental, and there is often considerable debate and disagreement among top managers as to whether the application of these criteria results in a deficiency being considered "material". Where findings of a deficiency have occurred, it often needs to be determined whether these represent a "local" phenomenon, or whether they reflect a problem in controls existing throughout the Customs system.

The samples used in arriving at audit findings are sometimes not large or representative enough to make such a determination. Therefore, the opinion of program managers becomes crucial in this judgement. In each case, the arguments for and against "material" status are carefully cataloged and weighed. When a deficiency is not reported in Customs Annual FMFIA Report as material, this does not mean that it is forgotten or that it is

not addressed. Non-material deficiencies are listed in Customs Financial Management Improvement Plan, or in one of Customs other similar internal improvement plans, and traced until problems have been satisfactorily corrected.

In the last ten years, Customs has identified 175 material deficiencies. Approximately 96 percent of these have been acted upon and closed out, as the following chart shows. We have subsequently discovered in a few cases that corrective actions have not been completely successful in eliminating problems associated with a deficiency. Where this is the case, the deficiency, or those relevant parts of the deficiency, are reopened and corrective action is taken to address continuing or residual problems. Often, normal changes in work processes require continuing enhancement of systems or revision of procedures to take into account new conditions and circumstances. Thus, the re-examination of previously closed deficiencies to determine if additional action is required is a normal part of a validation process. Eight validations were completed in FY 1992, and more are being completed in FY 1993.

There will continue to be questions as to why Customs has or has not reported a particular deficiency as "material" under the FMFIA process and regarding the stage at which a deficiency is deemed to be fully corrected, or simply in requirement of

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continuing management attention. However, Customs has established a comprehensive review and control system which minimizes the risk of deficiencies escaping notice, systematic planning for corrective action, and subsequent validation of that action.

Listed below are the FMFIA deficiencies reported to the President and Congress in Customs FMFIA Annual Report and the disposition of deficiencies identified through July 1993.

	<u>Number</u>	<u>Unresolved *</u>	<u>Percent Resolved</u>
<u>Prior Years</u> Customs	137	1	99%
<u>FY 1989</u> Customs	25	0	100%
<u>FY 1990</u> Customs	4	1	75%
<u>FY 1991</u> Customs	5	1	80%
<u>FY 1992</u> Customs	4	4	0%
TOTALS	175	7	96%

* As of 7/31/93

Since the inception of the FMFIA Program in FY 1982, the Customs Service has completed corrective action plans for 96 percent of all material weaknesses and non-conformances identified through the program. Most of the remaining weaknesses are subject to corrective actions involving multi-year systems design and implementation work. In some cases, subsequent validations or internal and external reviews of the efficiency of

these corrections have indicated the need for additional actions. However, the percentage of resolved weaknesses indicates the amount of work and the progress Customs has made in addressing material deficiencies.

SEIZED PROPERTY

Customs policies and procedures regarding the safeguarding of seized and forfeited property are detailed in Customs Seized Property Handbook and the Seized Property Custodian Handbook and other Customs Directives. Customs employees and its contractors are required to follow these controls. Seizure documentation requirements provide for completion of a Custody Receipt and Chain of Custody form for articles seized by a Customs officer. Automated records are also created to document the seizure. A history of the custody of seized property is not maintained in the current seized property systems, but a redesign of that system is in process to ensure a complete audit trail and history of the transfer of custody from seizure to final disposition of the seized property. Customs periodically reemphasizes the need for compliance with such guidance and conducts periodic on-site visits of seized property custodians' facilities. Even so, Customs recognizes more needs to be done in this area. To this end, the Agency will develop a plan to evaluate compliance with seized property policies and procedures and aggressively seek

compliance by the staff. The annual letter to Customs managers on CFO, emphasizes the importance of total compliance with guidance for seized and forfeited property. In addition, Customs redesign to its Fines, Penalties, and Forfeitures system will provide reliable seized property records. For example, the new system will provide for case processing on a line item basis for seized and mitigated forfeited property.

OTHER EFFORTS

Although Customs has made progress in resolving outstanding financial management issues, more needs to be done to provide reliable accurate financial statements based on adequate internal controls and reliable supporting data to meet the requirements of the CFO Act. As a result of GAO's June 30, 1993, report that showed GAO was unable to express an opinion on Customs fiscal year 1992 statements, Customs (1) began to address the issues noted by GAO in the submission of Customs Modernization Act, (2) enhance administrative systems to facilitate integrated accounting data and reports, (3) enhance procedures to compile data for the 1993 statements, and (4) continue to implement controls and systems that are acceptable.

- Customs Modernization and Informed Compliance Act will facilitate improved collection of outstanding debt and improved control over supporting documents for such debts. For example, (1) Customs would have the authority to use private collection agencies to expedite collection efforts, (2) electronic submission of bonds would result in more collections through the guarantee or payment by bonds, and (3) accounting for entries on an account rather than individual entry basis will facilitate resolution of delinquent entries and improve control over unpaid entries.

- Customs redesign of its revenue ancillary systems will afford improved internal controls with an integrated system that will compile and transmit data on a current basis to Customs core accounting system. The system will include the proper recognition of revenue and a receivable when a broker or importer defers the payment of taxes on an entry. Currently such data must be manually ascertained from different record files in the current revenue system and then manually recorded as an adjustment to the general ledger receivable account.

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- Customs is developing a plan to resolve the issues identified by GAO's report. Most importantly, Customs is evaluating the accounting principles and concepts used to prepare the 1992 statements and the changes necessary for the 1993 statements for discussion and concurrence by GAO. For example, Customs 1992 statements based the amounts of accounts receivable uncollectibles on prior collection efforts but, as agreed with GAO, Customs plans to evaluate selected debtors to determine such an amount for the 1993 statements. Also, Customs 1993 statements will recognize the potential liability for damage or loss of U.S. military aircraft loaned to Customs and reach agreement with GAO on the proper presentation of revenue collected for the Department of Agriculture.

- Customs is working with GAO in the advance planning of Customs equipment inventory, including the adequacy of procedures and training, the locations to visit for compliance testing and the proper valuation of equipment when documentation such as purchase orders and vendor invoices do not exist.

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- Customs is revising its year-end procedures to field offices to compile data for the 1993 statements and requesting GAO's opinion as to the adequacy of such procedures.

Customs recognizes that accounting principles require that an accounting system should, at any time, facilitate the preparation of financial statements, and Customs is committed to eventually meeting that requirement. In addition, Customs is committed to making a concerted effort to correct the deficiencies noted in GAO's report on Customs 1992 Financial Statements. Also, the development of Customs ADP Systems, including revenue, will include the necessary financial management data and internal control structure. It is Customs goal to provide reliable statements to ensure that Customs makes reasonable decisions from the data and forwards Congress data it can rely on.

United States Customs Service

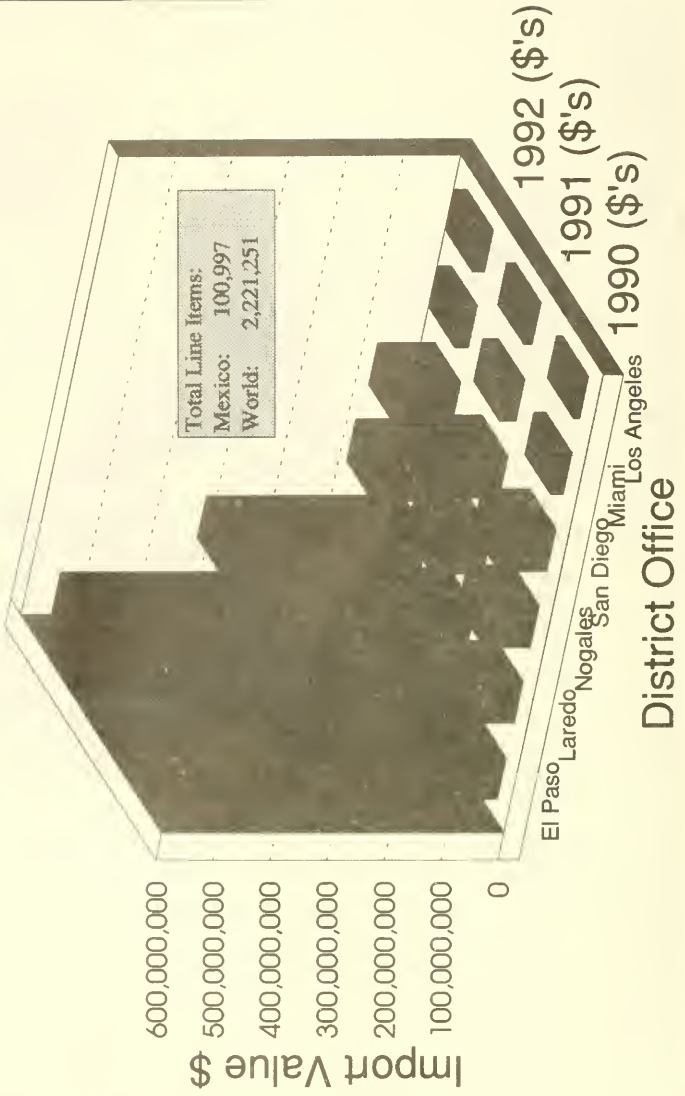
Nafta Textiles/Apparel

An Approach



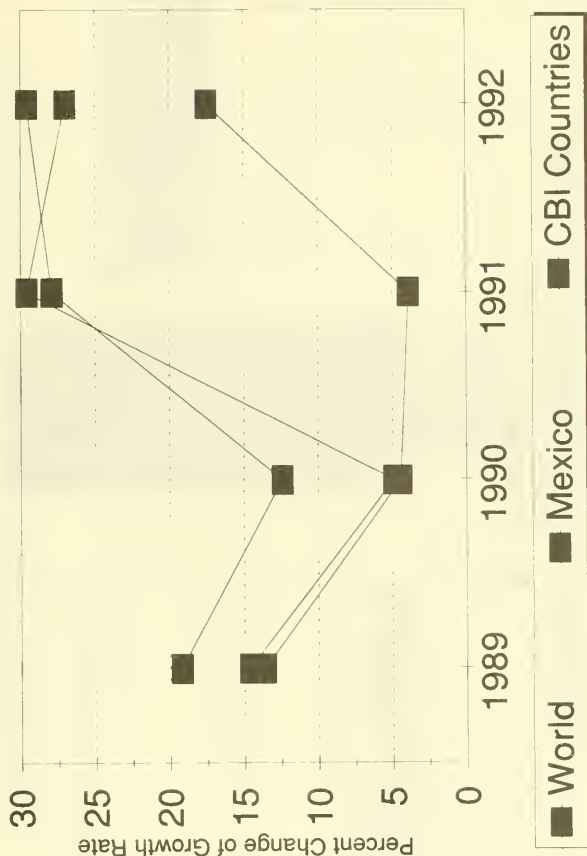
TEXTILE IMPORTS from MEXICO

Top Six Customs Districts

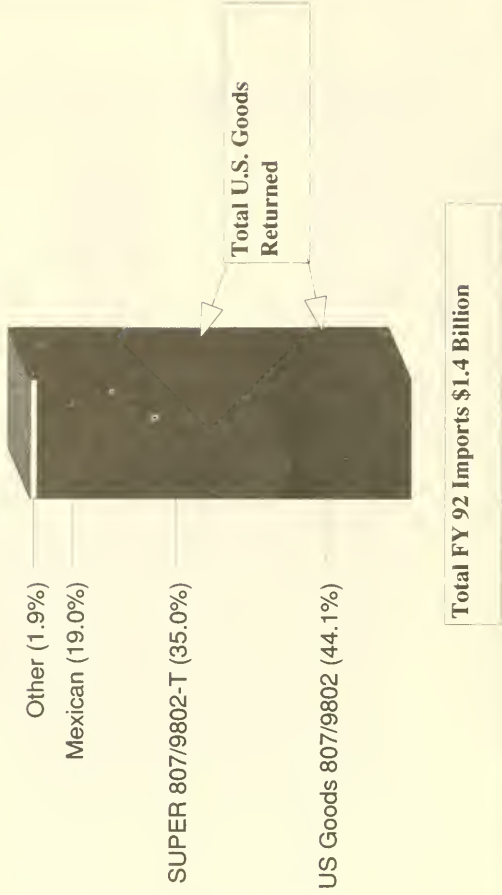


Mexican Textile/Apparel Imports

Percentage Change

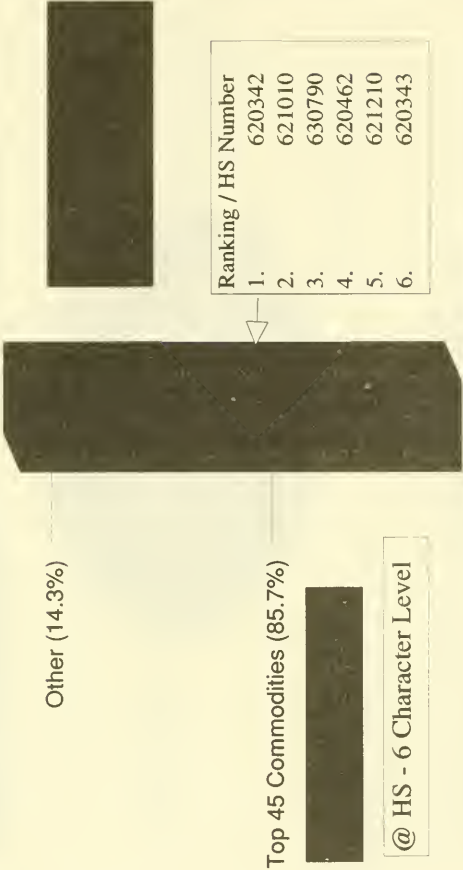


Mexican Textile/Apparel Imports **By Provision Code**



Commodities

Mexican Textile/Apparel Imports FY92



Mexican Textile/Apparel Imports

Top Importers



Total # of Importers 1,324

Total Value \$1.4 Billion

Mexican Textile/Apparel Imports

Top Manufacturers



Top 45 (46.7%)

OTHER (53.3%)

Many Small/Different Manufacturers.
Coverage Expanded to Commodity Level.

Total # of Manufacturers:
1,471

Total Value: \$1.4 Billion

Mr. SPRATT. Mr. Banks, thank you very much. Effective rejoinder.

Mr. BANKS. Yes, sir.

Mr. SPRATT. Mr. Nunez, whom I do not know, but I have read his speech, the Assistant Secretary of the Treasury in the last administration made a speech to the Customs bar last May, May 1992. And he said several emphatic things in it. He said, "The bad element within the trade community is no longer afraid of Customs. They believe that Customs examinations and audits are so infrequent and so cursory, that there is little chance they will be caught." Do you agree with that?

Mr. BANKS. There is some truth to it, yes, sir. I don't know if I agree that they will never be caught, because we do catch a lot of them. When the GAO came in and did the general management review, they did find that we had a fairly high voluntary compliance rate because of the reviews and the screening that we do. But, yes, we are not doing the number of audits that we should be doing. We are not getting out—if we really had—if we had the ideal situation, we would be auditing every major importer each 5 years.

We are probably on a 25-year cycle, so we are not quite where we would like to be.

Mr. SPRATT. And what would you audit these importers for, to determine if they properly reported duties voluntarily to brokers and independently themselves, and the assessed values, the declared values corresponded to the real values of the goods that were shipped in?

Mr. BANKS. Yes, sir, that is the core issue, and to make sure they are complying with all the trade laws of the United States. Some of them are very brief. We have all sorts of audits. We have compliance audits in which we look at foreign trade zones and bonded warehouses. We have fraud audits in which we go in based on referrals of our officers out there. We will send people out to just look at a very specific fraud issue.

And then we have what we call national audits, and we pick out a half dozen companies a year and we go in and do them from top to bottom.

Mr. SPRATT. Does that mean you think you have about a fifth of the number of officers you need?

Mr. BANKS. I am not willing to state it quite that way.

Mr. SPRATT. You said you are auditing about every 25 years. You need to do it at least every 5 years.

Mr. BANKS. I think we would like to refocus some of our resources. I think the GAO had a good point. The first place we need to start is, now that we have got the requirement lifted that we can relook at our structure and the way we are organized, I think we can free up positions to do other things.

Would we like to have more auditors? Yes, I would like to see them go into the audit area. Mr. Horn asked about electronic systems. I think we have got one of the most progressive automation systems in the Nation. We have tied in the entire trade community. We are automating other agencies in the process. We get 94 percent of the commercial shipments that come into the United States, we get that information electronically. And 10 days after that, we

get a chunk of paper that thick on every one of those shipments because the law says that is what we have to get.

Just folding, spindling, and mutilating that paper is an incredible effort. We take the documents, we don't look at over half of it, we put them into boxes. We put numbers on the boxes and then we store them in a room for 8 years like they are some fine wine. That is what we are stuck doing because that is what the law requires us to do.

If we can get out from underneath that, I think we get the capability to redirect our resources into some of these other areas, Mr. Chairman.

Mr. SPRATT. I first got involved in this issue some years ago, not long after operation trip wire. You recall that?

Mr. BANKS. Yes, sir.

Mr. SPRATT. The program had been carried out in a couple of key ports of entry. We went up to New York and down to Marr Terminal to actually see the inspection process take place. While we were at Marr Terminal, courtesy of the Customs Service and the New York regional office, the dock side inspectors, import specialists, a whole array of import people from Customs, gathered in a room and kind of let their hair down.

Usually you find people pretty restrained, particularly in the presence of superiors, but in this particular case, they began talking about what they had uncovered, given the resources, given the focus and the concentration on the problem, and it was phenomenal. And they told us that even when they were concentrating on the project of quota evasion and circumvention, that there was a substantial amount of fraud taking place that was undetected. They were still, even with this concentrated effort, only skimming the surface of the violations. Do you think that is still the case?

Mr. BANKS. As far as transshipment, I would agree with you that we have only got a partial solution at this point. But the thing is, it is not just something you can throw bodies at. First, we need the enforcement authorities to be able to go into these areas because you can't just sit at those docks and use import specialists and inspectors.

They are very good to determine what is the right classification, that is indeed, you know, men's jeans that are coming in and that there is 150 boxes. You can do that through inspection. You can look at the values and the invoices and the rest of it on document reviews. But the trouble is, when a jean shows up and it has got Guatemala on the label, how do you know it came from Guatemala?

You can look at all the documents you want in this thing. Unless you actually get down to those companies, you are not going to know they have the capability to produce that. And so it is a completely different direction that we need to take. And are we making a huge dent in it? Probably not. We have a long way to go.

Mr. SPRATT. We saw there that day at Marr Terminal the tension that a number of your witnesses talk about in their testimony between enforcement and facilitation. There is enormous pressure on Customs to move the goods, move them quickly. The importers are pressing upon you. The terminals obviously do business by being expeditious, getting the goods in and getting them out as

quickly as humanly possible. And they are all the time leaning on Customs.

In fact, in those days the terminals were accommodating Customs to the extent of letting you borrow their VAX DEC computers in order to try out your new software. You didn't even have it and they were accommodating you to the extent to use it there, because it facilitates the transit of goods through the terminal.

If you go to this new world of automation, by virtue of having something like the Trade Modernization Act, H.R. 700, adopted, do we go more in the direction of the facilitation by coming more hands off, relying more on computers and software algorithms to do the job that we now use human judgment to do?

Mr. BANKS. Well, let me phrase it slightly differently than that. The way that we are forced to do work under the current law is transaction by transaction. We must look at every shipment individually. That is when you get a chunk of paper. You have to look at each one all by itself in isolation. And to be honest with you, we don't think that is a productive way of doing business any more, because all you get is that little tiny slice of that business practice.

What we want to see is 6 months worth of transactions or a year's worth of transactions. What we want to see is where their volume—you take a company, an importer, you look at the foreign manufacturer, you link them together, and you take a look at where the volumes are going.

Mr. SPRATT. You are talking about data basing both for countries and for substantial individual exporters so that you can compare past data bases and current flows and determine whether or not there is a variation here that suggests that something is out of sync?

Mr. BANKS. That is exactly correct, Mr. Chairman.

Mr. SPRATT. I understand that one of your proposals regarding finalizing Mexican imports, under NAFTA if it comes into being, will begin with establishing a data base or baseline for key importers, key exporters, and manufacturers in Mexico.

Mr. BANKS. This is the last 12 months. We have already got the data in our computer system.

Mr. SPRATT. You have inventoried Mexican manufacturers and you are filling the data base already?

Mr. BANKS. One of the things we get, and admittedly like someone said, this is some voluntary compliance. We have to—you know, we do trust some of the information that we get. We verify it, a lot of it, but we do trust it. And we have got manufacturer ID numbers. So it isn't always perfect. Sometimes it is an exporter instead of the manufacturer, but for the most part, you know, we get a pretty accurate picture and we can tell you which importers are dealing with which manufacturers and which commodities, how much are they paying, and yes, we can put that all together.

We have already got it to the point that we are downloading it into PC's from our mainframe computer, and we are sitting there manipulating. We are not only doing Lotus, you know, charts.

Mr. SPRATT. All right. So that is my next question. No. 1, do you have the software, and does it work?

Mr. BANKS. We are experimenting with the software. I went down and saw it in New Orleans last week. We are bringing it up.

We are running it through a whole series of commodity lines this week.

Mr. SPRATT. Will it be accessible through workstations all over your offices?

Mr. BANKS. We have already got personal computers on almost all the desks of the officers on the southern border. We don't have all the LANS up, the local area networks that we need, but it will be up. We have got the money for it.

Mr. SPRATT. Now, could you take this model once it is perfected and apply it to other major exporting countries?

Mr. BANKS. As a matter of fact, we are. That is one of the things that we are looking at. But we are walking forward on this one at this point. And right now we are focusing heavily on NAFTA just because people want us to be prepared for that issue.

Mr. SPRATT. How did you compile the input data about the Mexican textile and apparel industry?

Mr. BANKS. We get it in on the commercial entries that we get today.

Mr. SPRATT. Just off the importer records?

Mr. BANKS. Yes.

Mr. SPRATT. Did you have any assistance from the Ministry of Trade or whatever it may be called in Mexico?

Mr. BANKS. No. Actually, this data is very detailed. It is company specific data. In fact, it is business proprietary, confidential information.

Mr. SPRATT. What you are looking at are trade flows from this country. You don't know what the production capacity or production capabilities of individual plants and firms are, just what they are exporting to this country? Is that what you have a handle on?

Mr. BANKS. That is absolutely correct.

Mr. SPRATT. What if we were to require in our bilateral negotiation that the countries with whom we were entering into agreements would supply us with information, some of which we would spot audit to make sure it was accurate, about major exporting firms, products that they were capable of producing, and their plants and the capacities of those plants so that you could build this data base. You would have an initial input that was supplied largely by them and verified to some extent by you.

Mr. BANKS. Mr. Chairman, I don't want to toss out any idea. And we are more than willing to consider that. At this particular point, because you asked us to build a model and that is what we are still trying to do, we want to take the top 25, the top 50 importers of Mexican textiles and apparel. That is who we want to focus on. And they probably represent close to half the value of the imports that come in, the top 45 do.

We want to take the top 45 Mexican manufacturers and exporters, and again they represent a significant portion of the value. That is out of, by the way, a 1,500 total universe. The top 45 are ones that represent the significant portion of the value. That is who we want to go in and visit with under the authority that was provided under NAFTA, where we give notification to the government that we are going to come down with import specialists and auditors and we are going to go onsite to do those verifications.

Mr. SPRATT. Do you have the resources to do this, manpower resources, hardware resources, money for software development?

Mr. BANKS. We are working on it.

Mr. SPRATT. Well, let me ask you specifically, you hesitated there, and there is word out that I suppose we are beginning the budget cycle for the next fiscal year right now, fiscal 1995. There is word out that Customs may be asked to take a cut, personnel and dollars.

Mr. BANKS. Yes, sir, we know that.

Mr. SPRATT. I would—

Mr. BANKS. We anticipate losing about 700 people over the next couple years.

Mr. SPRATT. Where will those losses come in—import specialists, auditors, dock side inspectors? Who takes the hit?

Mr. BANKS. We are going to try to take as many as we can under this reorganization effort from middle management, and some places that we don't think have been as productive, but sure, undoubtedly we will have to eat into some of the field resources. But at the same time, we have got field resources down there and we can reallocate some of those resources.

Now, especially if we get that modernization act, it would really free us up to do a lot of other stuff.

Mr. SPRATT. GAO just testified, you have testified yourself before, and the National Treasury Workers Union has been a long-time advocate of the proposition that more money and more personnel in the right places for Customs will generate a multiple several times the cost in revenues for the Federal Treasury. Do you subscribe to that proposition?

Mr. BANKS. Basically, although to be totally candid with you, we have never been able to really quantify what that marginal return is. We haven't been—

Mr. SPRATT. But you believe it is still there. You still think a marginal dollar of extra costs will yield more than that marginal dollar, that is in multiples of several times in new revenues?

Mr. BANKS. Yes.

Mr. SPRATT. So it makes sense to add people in the right places, right?

Mr. BANKS. Yes, sir. Actually, it is not just revenue that we are looking at, it is where you add them. Like on the jump team efforts, our estimate is for every dollar we spend on these jump teams to go into the foreign countries, we block about \$148,000 in illegal textiles from coming into the country. We either seize them or we block them or we charge back that to the countries involved.

Mr. SPRATT. I have a phenomenal statistic right here, again, from Mr. Nunez's speech, out of 694 inspections over 20 months, 553 factories turned up transshipment violations.

Mr. BANKS. Well, but understand that when we—

Mr. SPRATT. I can't do the statistics, but it is close to 80, 85 to 90 percent. Are you still finding the same pattern of violation when you actually send a team out?

Mr. BANKS. Into some areas, yes, sir.

Mr. SPRATT. Can you give us an updated number?

Mr. BANKS. When we send a team in, when we spend the money to send them overseas, internationally, we do all sorts of computer

runs to figure out which foreign manufacturers we want to go see, exactly which products we want to go after. When we go in we are pretty well armed with, you know, we think there are problems.

Mr. SPRATT. If you were to have the resources you need, I will give you a finite number, for example, say, the top 45 or 50 companies, at the frequency that you think is required, what would you need in additional auditors and import specialists? Or maybe not import specialists, auditors.

Mr. BANKS. Well, I guess what I would say is I don't want to say what we would need in terms of additional resources. I would say to you that the resources that we are going to try to put on those efforts is probably 50 to 75 people, a combination of auditors and import specialists and maybe some agents. That is what we anticipate having to reallocate from other areas to focus in on that, or from what they are doing today.

Mr. SPRATT. You just got handed a piece of paper. Maybe somebody's got the answer back there.

Mr. BANKS. Approximately 65 percent of the factories that we visited recently in the Dominican Republic, in August, actually, were found to be transshipping.

Mr. SPRATT. I have some more questions, but let me share some time with Mr. Horn and Mr. Green.

Mr. Horn.

Mr. HORN. Thank you, Mr. Chairman. How accurate is the declared value of goods in terms of exports in this country, as well as imports? We look at these trade balance data, and I just wonder how much faith we should have in them. How does that process work in terms of Customs' role?

Mr. BANKS. Congressman, we will vouch, at least give you a high degree of confidence on the imports, value of imports declared. We cannot do so on the exports. We have actually gone in and worked with the Census Bureau in order to try to find out how much is not reported on exports. And they estimate it could be like 4 percent, I believe it is. And that could be—I mean that is billions of dollars. We really don't focus in on exports to scrutinize value levels or that the commodities are indeed the commodities that they say they are.

Part of the reason is that we don't want to get in the way of exports, either. You know we are not trying to put a big burden on the exporters.

Mr. HORN. Where do we get those data? Do we look at what the import side of a foreign nation is to figure out that or what?

Mr. BANKS. Actually, in most cases we don't. We take it from the shippers. When they export, they provide us documentation and we pass that documentation on to the Census Bureau. And they either get it in an electronic fashion or they key it in.

In the case of Canada, because we worked out a total statistical reconciliation with Canada, we now take their import statistics and they take our import statistics. We are trying to work that out with Mexico at this particular point. We had about a \$5 billion, \$4 to \$5 billion discrepancy in trade statistics with Canada until we instituted that practice.

Mr. HORN. We now have a \$5 billion trade surplus with Mexico. In 1987 it was a \$5 billion trade deficit. Do you have much confidence about that surplus?

Mr. BANKS. I would say it is \$10 billion better than what it was, but if you are asking me do I think that it is absolutely accurate, I can't say that.

Mr. HORN. Not absolutely, but the probabilities of it. Are we 90 percent accurate, 80 percent accurate?

Mr. BANKS. Based on the work that the Census Bureau has done, I would have to say it is in the 90's. But it is low 90's.

Mr. HORN. What are we generally taking, retail or wholesale value, what? What kind of number gets put there?

Mr. BANKS. OK. And once again, it depends. We get a lot of values for the other countries, and they include things like the cartage, the insurance, and the freight costs, something we don't do on the import side. So that is the reason we have to do this statistical reconciliation in the first place.

What we get on the import side and what most countries are going to get is what is called transaction value. And that is actually the invoice. What did you pay for the product?

Now, there are differences in the countries in terms of how they may handle such issues as royalties or how they handle such issues as cost, for, you know, insurance and freight. But most of that is fairly well known. We are, for the most part, on an international system of valuation now.

Mr. HORN. Do we have a feel for the fact that most of our trade with Canada and Mexico, or maybe other countries in general, come in with a wholesale value on it, because they are being sent to a wholesaler, or is there an ultimate retail value in terms of markup? What are we talking about?

Mr. BANKS. Well, actually it depends on how it was sold. Most stuff that comes in would be on a wholesale basis, but that is what we are doing. But in some cases where you have got individual purchasers, no question it is on a retail basis. We don't deal on that. We take whatever the transaction was, whatever the price paid or payable was.

Mr. HORN. And obviously enough, the interest of the person exporting to us, the imports in this country, is to keep that as low as possible so they do not get a Customs levied.

Mr. BANKS. Well, that is true as far as Customs goes. But like if you were importing it into a manufacturing plant in the United States, you may want to raise the value for tax purposes. Actually, there are incentives to go in both directions.

Mr. HORN. Let me ask you on your preclearance overseas, I had the pleasure of going through your system in Canada. I think the year was 1975. I thought, what a great idea. How far has that spread at airports and ports to go through preclearance in the case of Customs? INS also had it with Canada.

Mr. BANKS. It hasn't gone too far for Customs. And part of the reason is that even though it does facilitate the movement of people from Canada and we have got it in Bermuda and we have got it in the Bahamas, the difficulty with it is we really can't enforce United States law there. So when we find a law violation, some-

times they can just turn around and walk on us. So we have reservations about expanding it too far.

Immigration is expanding what they call preinspection. Because all they do is they are going to just turn the people away anyway, so they do find it useful and they are going into Frankfurt and some other places.

As part of this technology drive, one of the things we have done is we worked with the airlines and we got machinery for passports now. And when you check in overseas, we have given readers, these document readers, to the airlines. And what they do is they swipe your passport in over there. We will get the whole—everybody that is on the flight, before you depart. We run it through all our data bases, so we decide who we want to talk to before you land. Probably 30 percent of the air passengers that come into the country are now handled that way. And so it is a real expedited process.

When you go into the U.S. airports now, you line up at the Immigration booths, but you don't line up at a Customs booth anymore. We do it basically through the targeted mechanism of the advanced information and we use rovers, which are Customs people generally trying to spot violators based on behavioral anomalies. We use small dogs for dope. They come by and sit down next to you.

Mr. HORN. I have watched those dogs in action. They should be at least GS-14's in terms of effectiveness.

Mr. BANKS. I worked for them before. [Laughter.]

Mr. HORN. One of the arguments that we hear as to why we do not have more preclearances, the Department of State doesn't—or the local ambassador that we send doesn't want all these extra people he has to worry about. How much truth is there to that?

Mr. BANKS. That is a general truth on assigning people overseas. However, I don't know if that necessarily applies to preclearance. They are also looking for good will with the other countries, and in some cases State has actually tried to push us to go into preclearance, when we haven't wanted to because we don't feel like we got the legal authority to do our job.

Mr. HORN. Now, do you need diplomatic status for your people overseas?

Mr. BANKS. We don't have that, no, sir. Actually, I don't think we got it where we have somebody that is directly assigned to the embassy, because we have got a variety of overseas offices. They do have certain status. But our preclearance officers do not have that, and that is a problem, that is a difficulty for us.

Mr. HORN. How much of the problem is it and what sort of problem is posed by that?

Mr. BANKS. It has been a big enough problem that we have been fighting like cats and dogs with the Canadian Government for about the last 3 or 4 years in order to try to get certain privileges extended to them. One of the biggest concerns we have is Canada has no money enforcement laws for the movement of money and we do. And so we require somebody to report if they have got over \$10,000 in cash currency and negotiable instruments.

If we would actually stop somebody, you know, pull the money, our officers could be sued. They don't have immunity for doing that activity. We don't have law officer status in a foreign country. So

to be quite candid with you, we have real concerns about it. We are not real thrilled about this.

Now, I think we are starting to make some progress. I apologize to you. I am not currently up to date on all those negotiations. I think we are making some progress. But we don't want to leave our officers hanging out on a limb in that environment and that is the reason that we have kind of taken a very cautious attitude toward spreading preclearance.

Mr. HORN. To what degree were these part of the NAFTA negotiations——

Mr. BANKS. None.

Mr. HORN [continuing]. With Canada?

Mr. BANKS. None.

Mr. HORN. They weren't.

Mr. BANKS. None.

Mr. HORN. They are a separate bilateral agreement——

Mr. BANKS. Yes, sir.

Mr. HORN [continuing]. That is completed?

Mr. BANKS. Completely different. In fact, we really don't have passenger traffic in NAFTA with the exception of tools of the trade, and that sort of thing.

Mr. HORN. Well, thank you. You are a very eloquent witness, Mr. Banks. Maybe they can erase the "acting" from in front of your name.

Mr. BANKS. Just fine the way it is.

Mr. SPRATT. Mr. Green.

Mr. GREEN. Thank you, Mr. Chairman.

Mr. Banks, you heard my questions earlier to the GAO concerning the amount of the fines levied and the actual mitigation. And I know some of that is maybe not in your hands. It may be in the Justice Department. Oh, it is all in yours?

Mr. BANKS. Not everything, but a great deal of it is, sir.

Mr. GREEN. So there is none of it plea bargained away in the Justice Department, it is all in Customs?

Mr. BANKS. Well, when a case actually goes for civil prosecution, then it is not. But most of the fines, penalties, and forfeitures are handled in an informal manner, so we do a great deal of it. And there is no question that we can go in with a very high level.

The authority of the law says we can go in with a high level. And part of the reason we do that is we haven't done an investigation at this point. We don't know how culpable those people are. If they end up being culpable of fraud, we are going to go the whole way. In the vast majority of cases, they are not. It could be gross negligence, it could be simple negligence, or it could be that they really didn't intend to do anything at all and there might have been a clerical error. So that is our difficulty. We always start high.

Now, GAO has gone in and at least looked at two of our field offices and come back and said we are not going to bring this to you as a national concern at this point. So I think they have even reviewed some of our field practices on this effort.

Mr. GREEN. OK. Well, let me give you an example. And I know the problem of going to other countries and the access you have had from your testimony, but also from the reports. For example, we have XYZ shirtmaker in the United States. They may import

from all over the world. It should be on that responsibility for that shirtmaker whether it is from Malaysia, Sri Lanka, Republic of China, or anywhere else. And for them to know, because they are the actual importer, or they handle the brokerage to bring it in.

Now, I can see clerical errors happening, but I can also see that that importer, the one that is—and I guess it is frustrating, when I hear from constituents, they go to the department store and they may have XYZ manufacturer, may have three or four different countries of origin in the same batch that may be sitting on that shelf, and why wouldn't it be more on that importer, and again for them to follow it through and once they get caught because of the investigation, then the fines are easily commensurate with the profit they may make.

Mr. BANKS. For a starting point, Congressman Green, the way the law currently reads, it is really the Customs' responsibility to determine much of this information. All the importer is legally bound to do is to give us an accurate invoice. That is all they have to do.

Mr. GREEN. So there is no requirement that they mention country of origin or that be anywhere near accurate?

Mr. BANKS. No, there are certain requirements for country of origin. But one of the biggest problems we have got is we are heavily automated at this point, and so instead of getting actual invoices in many cases we run many of our selectivity systems based on electronic data that is submitted to us. That is manufacturer ID number, it is a commodity number. The legal responsibility for them to give accurate information is at least shaky.

That is one of the things that we have done under the Customs modernization act. It is called shared responsibility. They must use reasonable care in providing that information. It puts a greater burden on them to give us accurate data. And that is one of the things that we really see as a fundamental reason why we need this modernization act.

Now, the thing is, even though if they give us an invoice and that invoice is false, we can take action against them. First of all, if we find that the goods were transshipped, we can ask for a redelivery of the goods. And by that, that means it has gone through our system, the importers have got it, they are taking it out of the market.

We can ask for redelivery, in most cases especially on textiles. By the time we ask for it they can't redeliver it. It has gone. And there are penalties associated with that. When you can't redeliver it, there is a penalty associated with it automatically.

In addition to that, you look behind the level of intent. Did they know that they were buying from, you know, that they knew they were importing transshipped goods? Trouble is, it is not easy. I mean those are big investigations. We have a lot of them under way, but they are not easy to do.

When we do this operation, the Q-TIP up in New York, I mean we had like 700 investigators from—we not only used Customs investigators, we borrowed from IRS because it was so big, too huge. And it has been a year probably, plus, just to do the investigation. You get to the big companies, you get to the ones that are really blatantly violating the law. It is a big effort to undertake it.

Mr. GREEN. And I agree with the modernization and the use of computers, but our information is right now that 1 percent of all imports of textiles and apparel are physically inspected by Customs. Would you expect that percentage to go up or go down if we provide additional computerization?

Mr. BANKS. Actually, it is higher than that. You know, you hear a whole variety of numbers, but I can tell you that our average inspection rate is about 6 to 7 percent right now. On the southern border, it is about 8—I think 8.6 percent.

I can give you that exactly if you want that. Now that includes everything. That includes containerized cargo, that includes air shipments that come in bulk. So our examination rate is higher. But it is still—it is a minority. More than 90 percent goes down the road without exam.

Mr. GREEN. OK. The chairman asked the question earlier about typically you would think in Customs that if we provided additional inspectors, where maybe it went from 8 percent or 8.6 to, in the southern borders, to 20 percent, you would see additional revenue generated. And in your response to that, you weren't sure about it again. Being a freshman and having worked in State government, if we went to our State controller, by the way, who got all sorts of good press from the Vice President about it, we would add 100 more inspectors to investigate gasoline stations to see if they were paying the gas tax.

We could see after a year they actually went out and found some of those invoices may not have been quite correct, whether they hand delivered the invoices or they sent it by computer, if we could see that additional revenue.

In your response you weren't sure that you could see that, if we provided that.

Mr. BANKS. In many cases you are not going to see additional revenue. If it is textile transshipment, it is not going to be more revenue. We are not going to collect more money, more duty, as a result of somebody transshipping something.

What we are going to do is block illicit textiles from coming in, but it is not going to be a dollar return, more duty.

Mr. SPRATT. But you will collect penalties and assessments.

Mr. BANKS. There is no question that in some cases you can get penalties. The trouble with the penalties is many times that is a multiyear effort in order to know what your final collection is. In fact, that is one of the things GAO beat on us for, that our fines, penalties, and forfeitures automated system doesn't track it from the very beginning all the way to the very end. And that is part of the reason I can't tell you, because, you know, that is one of the things, that is a system weakness that we are correcting, but we don't have it yet.

Mr. GREEN. Thank you, Mr. Chairman. I appreciate the testimony.

Mr. SPRATT. Thank you, Mr. Green. Just a few followup questions, then we will go to our other administration witnesses. We have a whole galaxy of estimates about the nature and size and magnitude of this problem.

You were quoted most recently as saying the problem is about a \$1.5 billion problem, a conservative estimate of apparel exporting,

illegal transshipment out of China alone. That was September 28. A few months back, Thomas Gray, who is in Hong Kong, had a much larger figure. He was quoted in *Forbes* as saying illegal transshipments out of China alone are \$4 billion. Who is right, and how do you derive this number?

Mr. BANKS. The reporters are wrong. What I actually said, and it was reported basically accurately, but what I said is there is—we don't have a science for knowing the level of transshipment. I can't give you anything that we could take into a court of law.

Mr. SPRATT. You came up with a number of \$1.5 billion. What was your base for extrapolating that number?

Mr. BANKS. Basically, what we did is we take the trade statistics out of a couple countries, just use this as an example of what goes into this mix of trying to do this estimation, and we took the trade statistics, and the countries that were involved, their trade statistics were \$3 billion higher than what we received.

Well, where did they go? They were destined for the U.S. market, and it was over a 2-year period. So it indicated that somewhere along the line there is a \$1.5 billion gap a year in this thing.

Now, some of it could have been attributed to the fact that we value things differently. There are other trade statistics, reasons why it could be somewhat different. But there is definitely an issue. What I would actually like to rely on more heavily is the fact that we have gone into those 32 countries and in 27 of them we found huge problems. If you actually take a look at the total exports from those countries to the United States, you could take a pretty conservative estimate that the problem is a \$2 billion problem.

I get nervous about quoting a number only because—

Mr. SPRATT. Whoa, whoa. You are saying there is a \$1.5 billion problem out of China alone, and there are 27 countries where you have found transshipment when you actually inspected. We extrapolate from one country with \$1.5 billion and just another \$500 million for the next 26 countries?

Mr. BANKS. No, sir. The \$1.5 basically was a statistical way to determine this thing, based on trade statistics. This was one way to analyze what the discrepancy is or what the possible transshipment is. Another way to do it is through the jump teams and their findings and then try to extrapolate that.

Mr. SPRATT. Which is experimental instead of analytical.

Mr. BANKS. That is correct. And even where we do those jump teams, for the most part it is still out of China. The actual origin of the goods was China. It is just they were transshipped through those other countries. And that is what the jump teams found.

Mr. SPRATT. I see. You are talking about transit companies.

Mr. BANKS. Yes, sir. We look at a variety of weights. One, we do some trade statistic analyses to try to get a picture of how big this thing is. It gives us one indication. We use the jump teams, and that gives us another indication. And to be quite candid, we also use confidential informants that know the industry pretty well, and they give us figures. But none of it can you walk into court with, it is just, you know, it is the best guess we got.

I am sorry we ever started this thing, but we can say straight-faced that the \$2 billion number is probably a conservative estimate. But that is all it is, an estimate.

Mr. SPRATT. You mentioned the fact that most of these cases originate in China.

Mr. BANKS. Yes, sir.

Mr. SPRATT. Lots of different countries, however, are used as the ostensible country of origin, transit countries.

Mr. BANKS. Yes, sir.

Mr. SPRATT. Do you think we are too lenient on the transit countries? Would we improve our leverage and our deterrence if we let them know we also held them responsible for the use of their quota or the misuse of their quota?

Mr. BANKS. Well, we have to some extent. Maybe we could do it better. That is one of the issues I know that is being seriously contemplated through Jennifer Hillman and Rita Hayes and this transshipment task force.

When we found the rampant problem in Macau of sweaters being transshipped, we really clamped down pretty hard. The Macau Government responded and introduced a whole series of measures in order to improve it. So I think that the additional pressures will help rather than hurt the problem.

Mr. SPRATT. We have been told that the importers of various goods out source their production. They know the people where the products are produced personally, face to face. They sometimes deal through freight traders and brokers, but quite often face to face. And that along the Pacific Rim and in the Far East there is a growing discrepancy or disparity in wage levels, such that in Taiwan and Hong Kong, for example, wage levels are approaching \$3, \$4, \$5 an hour in the apparel industry now, whereas in China they are still 35 to 50 cents an hour.

Given the fact that there is a high labor content in apparel goods, this cost differential shows up; and, it has been alleged to us that an astute buyer would readily recognize in the price variation whether or not the goods he was pricing and procuring were going to be produced in Hong Kong or Taiwan as opposed to mainland China.

Do you accept that theory, and should the importers be held more responsible themselves? Do they really know what is happening and simply blink at it and get away with it?

Mr. BANKS. Well, you have got several questions there. One, the logic would indicate to you that there is a transshipment problem opportunity. At the same time, I want to say that Hong Kong has instituted tremendous measures, they have gone to extreme measures in order to try to control a number of things. A number of both the administration people and the industry people that are going to testify went on that trip to see how they were operating.

The importers cover the full range. Some of them know. I have no doubts that they know. Some of them we have indicted in the Q-TIP operation, and they have been convicted, so we have proven in court that they know. Some of them probably don't know. I am sure there are some of them out there that don't have the slightest idea; all they know, they are just ordering something. And then I would say there is a large number that don't want to know. They

don't want to know this issue—just turn a blind eye to it. "I ordered this and this is what I got."

Mr. SPRATT. Is not wanting to know in the face of obvious facts negligence such that we can penalize them if we catch them?

Mr. BANKS. It is tough to do it. It is very tough to do it. It is very tough to show, because even the negligence, that is a level of intent. It is probably very tough to show. We have done it, but it is not easy.

Mr. SPRATT. Two final questions. First of all, going back to my 1-day experience at Marr Terminal in your New York office.

Mr. BANKS. We have got to get you up there again.

Mr. SPRATT. I want to go back. The Customs inspection and enforcement personnel we met felt that the U.S. attorney, particularly in the busy southern district of New York, gave these cases a very low priority. He was more interested in drug kingpins and antitrust and high-profile prosecutions, as opposed to these penny ante Customs violations. Is that still your experience? Are you getting the cooperation, the vigor, and the commitment that you really need out of the U.S. attorneys?

Mr. BANKS. That is probably still an ongoing perception, at least. And some of the U.S. attorneys, like the work that we have gotten out of New York recently, are just wonderful. And others we probably have a more difficult time convincing. It kind of goes from location, to location, to location.

But the Justice Department has been real good about coming in and trying to work with us on this thing. As a matter of fact, we will have a major training effort under way in mid-December in order to take all the U.S. attorneys, and we are going through all of the fraud issues with them in order to try to get greater support. So this is one that is a two-way street. We need to work together with them better. Sometimes these transshipment cases are tough to take to a jury, too. You know, they are—

Mr. SPRATT. I think you would agree that you are never going to detect all the cases or even anything approaching 50 percent of them. And consequently, to be effective and to have integrity in our system and rules that people play by and abide by, we have got to have deterrence as our major law enforcement scheme.

Mr. BANKS. Yes, sir.

Mr. SPRATT. Do you think that the penalties, the frequency and manner in which they are applied today, are sufficient to deter transshipment, quota evasion, fraud, and circumvention?

Mr. BANKS. Not totally. And that is one of the issues that we are raising in the transshipment task force, that very issue.

Mr. SPRATT. Stepping up the penalties.

Mr. BANKS. In certain areas, yes, sir.

Mr. SPRATT. Mr. Banks, thank you very much. You have been a very effective witness. We don't want you to go unless you have to go. We have got another government panel. If you would like to sit there and participate in it, we would be delighted to have you. If you need to leave, we will understand.

Mr. BANKS. That is all right, sir, I will stay.

Mr. SPRATT. I would like to hear all the other members of the panel, Jennifer Hillman, Rita Hayes, who is the Deputy Assistant Secretary of Commerce for Textiles, Apparel, and Consumer Goods;

and Mr. Mark Richard of the Department of Justice. Thank you very much.

Ms. Hillman, welcome to the committee again. We have already received your testimony and if there is no objection, we will make it part of the record as prepared and submitted. You can summarize it or proceed as you please. The floor is yours. Thank you very much for coming.

**STATEMENT OF JENNIFER HILLMAN, CHIEF TEXTILE
NEGOTIATOR, OFFICE OF THE U.S. TRADE REPRESENTATIVE**

Ms. HILLMAN. Thank you, Mr. Chairman. I appreciate the invitation to appear before the committee and want to thank you and this committee for its attention and interest in this issue of textile transshipments. As you know, this is a matter that this administration and the U.S. Trade Representatives' Office takes very seriously.

The continued practice of transshipment, the circumvention of our textile quotas by sending goods to the United States labeled as though they were made somewhere else, is one that threatens the integrity of the multifiber arrangement, and which this administration will not condone.

As you know, the United States Customs Service has estimated that China is the major perpetrator of such transshipment, and has alone transshipped almost half again as much as their lawful quota levels. Other areas are engaged in transshipping. Goods have been transshipped through over 40 countries.

Generally, we believe that very aggressive steps must be taken in order to address the problem, as we believe the practice of circumvention hurts all legitimate players in the system. The legitimate manufacturers, importers, exporters, are all economically disadvantaged by those who refuse to abide by the rules and who break the terms of trade agreements.

At USTR, we have been working on a three-pronged strategy, a three-step strategy to try to address the problem of textile transshipments. The first involves a specific approach to the bilateral textile agreement with the People's Republic of China. The second involves specific language that we are attempting to negotiate in the 25 textile agreements that expire by the end of this year. And the third is the issue of the textile transshipment task force, the interagency group looking at this problem.

In terms of China, we fully recognize that China is, first of all, our single largest supplier of textiles and apparel. In 1992, China sent us over \$6 billion worth of textiles and apparel, a little over \$4 billion of which was covered by the multifiber arrangement and covered by our bilateral agreement with China.

We began negotiations with the Chinese on September 2 and 3, in terms of renewing their bilateral agreement. At that time, the United States laid out a very aggressive approach to the Chinese that basically said we have three major problems with you in terms of your textile trade, and we insist that these problems be corrected before we complete a new bilateral agreement.

First and foremost is the problem of transshipping. We said that we cannot and will not tolerate the level of transshipping that is coming out of China and that we must see a reduction in it and

aggressive steps taken by the Chinese if we are to complete a bilateral agreement with them.

Second, we emphasized the problem we have had with them in terms of overshipping. A very significant percentage of Chinese goods come in with fraudulent visas. This means that we end up at the end of the day embargoing quotas of Chinese goods very early on in the year, because such a large volume have come in with fraudulent visas.

And third, we emphasized to the Chinese the continuing problem that we are having within counterfeiting. Counterfeiting of textile continues, counterfeiting of U.S. trademarks, fake every kind of apparel item you can imagine. So we have emphasized those as three significant problems we have with the Chinese and that we must address those before we complete a bilateral agreement.

To do so, we have proposed three things that are changes to our current bilateral agreement with China. First of all, we have proposed new and much tougher language itself in the bilateral agreement to address circumvention. Second, we have proposed quite significant reductions in the overall level of quotas for China and said that we would only give those quotas back once we see actual effective reductions in the volume of transshipment. And third, we have proposed cutbacks in both the quota growth levels and in the flexibility provided in the agreement.

We will insist on including these new provisions in the bilateral in order to create incentives to stop the transshipment, as well as penalties when the transshipment does occur.

The second step that we are taking is a more across-the-board step to try to put new language into all 25 bilateral agreements. I have the great pleasure of trying to complete 25 agreements in a 6-month time span, and while that is a tremendous burden, it also gives us an opportunity to put in place a set of procedures that would apply to the vast majority of our trading partners in this area.

In doing that, we have tried to put in new language that is much tougher on this issue of circumvention, and which gives the United States much greater rights than we have currently in our bilateral agreements. And basically the changes from where we are right now include five major differences from our current language.

First, the language clarifies our right to charge the quota or what we would call a statistical correction to the record. When we find goods have been entered labeled, say, made in Malaysia, but we subsequently find out that they were, in fact, made in China, we believe that we have the right to go back into the records to correct them so the quota is actually deducted from China's quota, and typically Malaysia's quota would be recredited.

We have always believed that we had the right to do these corrections. Our right to do so was brought into question most recently in a case brought against the United States by the Government of Pakistan, which was heard by a group called the Textile Surveillance Body in Geneva.

The Textile Surveillance Body was unable to resolve the question of whether the language in our current bilateral agreements gives us this clear right absent the transshipping country's agreement which is very hard to achieve. So among the changes that we are

seeking in this language is a clarification that absolutely the United States does have the right to make this correction, even in the absence of an agreement with the country involved about the level of the transshipment or the fact that it occurred.

What we found in the past is that countries have an incentive not to ever agree with us, because if no agreement is reached, their perception is that we cannot make this change to correct the quota. Therefore, we are seeking these changes to ensure that no country has an incentive not to reach an agreement.

Second, we have run into a problem regarding the issue of how much evidence we have to get and what happens when governments do not cooperate with us. In this instance, what we have tried to do is add into the language the notion that if we have some evidence indicating that we think transshipment has occurred, but not all of the evidence that we would need to absolutely prove a case, that we can then go to the government involved, ask them for the kind of cooperation or information that would respond to this, and if they refuse to cooperate or refuse to give us that information, then we will tell them that we will go ahead and make the corrections to the quota. Either they are going to give us the information we need to show that we are wrong, or we are going to go ahead and charge the quota.

Third, the language adds the clear right that Mr. Banks has talked about, to send in U.S. jump teams, to send in Customs inspectors. We have made it very clear that we believe we need the right to insist on unannounced plant visits where we can send in a joint team with the country involved and U.S. Customs inspectors to inspect plants to find out whether they are, in fact, producing the goods that they say they are sending to us, and whether or not they are capable of producing the volume of goods that are recorded.

That is another point that we are insisting upon in these new bilateral agreements. Fourth is an issue you mentioned earlier about whether we can and are taking action against the transit countries, because again it has always been an issue that we can charge the quota of the country that made the goods. The issue comes up, what can we do to the country through where the goods transited?

Again, we are for the first time in this new bilateral agreement seeking language that makes it very clear that if a country allows its quota to be abused and takes no steps to stop the transshipment, that we will be able to charge their quota as well. Or to establish new quotas for countries that don't have them, if they simply allow themselves to be used as transit points, allow their names to be sewn into the labels of goods that they did not manufacture, that we will take action against these transit countries.

Finally, the language introduces a concept that we have never before had in our bilateral agreements that is a notion of a penalty level of charge to the quota. In the past, as I have explained, we have only done what we would call a statistical correction. If you sent a million dozen jeans in, you labeled them made in Malaysia, they were really made in China, at the end of the day we have simply assessed China's quota a million dozen jeans, since that is exactly how much they made.

For the first time, we are introducing the concept of a triple charge, that we would instead charge China 3 million dozen of these jeans, if they have transshipped them, but would spread that charge out over 3 quota years. We spread that charge out in order to be fair to importers who need to know the level of the quota, but we introduced the concept of a triple charge to make it very clear that we are going to insist on objections that create penalties for those who continue to engage in the transshipping problem.

So far we have reached agreement now with the Czech Republic, the Slovak Republic, the Republic of Korea, Rumania, and the Arab Republic of Egypt, all including this new anticircumvention language. We have not completed any agreements without it. We are insisting that this new language be incorporated into all of these new bilateral agreements. We have also had very helpful discussions with the Caribbean and the Central American countries about including this new language in all of our agreements with them. So we are making very good progress in trying to get our trading partners to work with us to address this problem.

We will continue to insist that this new tougher language be included in all of our bilateral agreements, both in order to give the U.S. Customs Service the rights that we believe they need, as well as to give the U.S. Government the rights that it needs to police the quota system.

The third step that we are taking is to focus efforts not only on our trading partners, but what we can do here at home to address the transshipment problem. And that lies in the efforts that are being undertaken by the interagency task force on textile transshipments that Rita Hayes and I both chair. We believe the basic goal of this task force is to come up with a multifaceted, coordinated approach across all of the agencies that have jurisdiction over this issue of textile transshipments to work together.

Clearly a number of the agencies are already taking good and important steps. The point is to make sure that we are all working together, that we have a strategy that comes up with the broadest array of possible answers and solutions to address it, and ensures that all of the agencies are working together in a coordinated approach to try to address the problem. I think the work of the task force is going very well. We began in August. We have had a number of extremely productive meetings where we have put together a series of options that the task force will now consider.

What are among this array of options, what are the best, the most appropriate, the most cost effective for us to take. We believe that we will be forwarding those task force recommendations fairly soon. And again, we then hope to put in place a multifaceted approach to take actions both here at home and with our trading partners so that we are addressing this transshipment problem in essence from both sides of the issue, both from the importer perspective and from the exporter perspective. And we believe that the combination of these three efforts, a specific China approach, a bilateral approach with all the rest of the countries, and the transshipment task force approach, is going a long way to correcting the problem.

There is no question that this administration believes very strongly that we must have effective enforcement of our trade

agreements, and that the level of transshipment of textiles clearly violates those agreements and threatens the very integrity of the multifiber arrangement and our quota system. It hurts U.S. workers, it hurts U.S. jobs, it is not something that this administration will allow to happen. And we will not do business as usual. I think we are taking a very, very aggressive approach to try to address the problem.

It is a very tough problem to get a handle on, but I think this administration is absolutely committed to doing it, both here at home and with our trading partners, and we hope by the end of this year to begin seeing some real results from these efforts. Thank you.

Mr. SPRATT. Thank you very much indeed.

[The prepared statement of Ms. Hillman follows:]

TESTIMONY OF JENNIFER HILLMAN
AMBASSADOR-DESIGNATE
CHIEF TEXTILE NEGOTIATOR
OFFICE OF THE UNITED STATES TRADE REPRESENTATIVE

BEFORE THE COMMERCE, CONSUMER AND MONETARY
AFFAIRS SUBCOMMITTEE
COMMITTEE ON GOVERNMENT OPERATIONS
U.S. HOUSE OF REPRESENTATIVES

OCTOBER 5, 1993

Thank you, Mr. Chairman. I appreciate your invitation to appear before the Committee to discuss the issue of illegal textile transshipment. As you know, this is a matter that this Administration and United States Trade Representative's Office takes very seriously. The continued practice of transshipment -- circumvention of textile quotas by sending goods to the United States labelled as though they were goods of one country when they are actually made in a different country -- is one which threatens the integrity of the Multifiber Arrangement and which this Administration will not condone. As you know, the United States Customs Service has estimated that China is the major perpetrator of such transshipment, and has alone transshipped almost half again as much as their lawful quota levels in the past. Other countries are also engaged in transshipping, and goods have been transshipped through over 40 different countries.

We believe that very aggressive steps must be taken to address the problem, as the practice of circumvention hurts all of the legitimate players in the system -- legitimate manufacturers, exporters, importers and retailers. All are in

some way economically disadvantaged by those who refuse to abide by the rules of trade and the terms of their trade agreements. In addition, we believe that the additional imports over what is authorized in our trade agreements hurts U.S. workers and U.S. jobs. This Administration is fully committed to the tough enforcement of our trade agreements to ensure that all those involved in trade play by the rules so that no one is unfairly disadvantaged.

USTR has been working, in conjunction with other agencies, on a three-part strategy to address the problem of textile transshipment. The first involves a specific approach to the bilateral textile agreement with the People's Republic of China, which is the country involved in the most significant amount of transshipment; the second involves specific language we are attempting to negotiate in each of the twenty-five bilateral textile agreements that are up for renewal this year; and the third is our participation and leadership in an interagency task force regarding textile transshipment.

China's Bilateral Agreement

In the first week of September, USTR began its consultations with the People's Republic of China with respect to the renewal of the bilateral textile agreement with China. The agreement expires this December 31st. In those consultations, the United

States made it quite clear that significant problems exist with our textile trade with China and that those problems must be addressed if we are going to conclude a new bilateral agreement with China. We noted that the key problems are: first and foremost, the problem of textile transshipment; second, the problem of overshipments, whereby China exports quantities far in excess of those permitted under the agreement, with many of the entries coming in under fraudulent visas; and third, the problem of counterfeiting of U.S. textile designs and apparel trade marks.

In terms of transshipment, we have proposed that the new agreement include new, tougher language regarding circumvention of the agreement through transshipment and significant reductions in China's quotas, with the notion that the quotas could be restored in the future if the Chinese stop the transshipping. We have also proposed cuts in the growth and flexibility provided in the current agreement. We have made it very clear to the Chinese that we will not continue to do business as usual, given their clear and repeated violations of their past textile bilateral agreements. We will insist on including provisions in the new bilateral which give incentives to stop transshipping and which provide penalties if the transshipment continues. We believe that it is essential that we achieve an agreement with China which can and will be enforced.

Bilateral Textile Agreement Language

The second step we are taking to address the problem of textile transshipment is our effort to include in all bilateral agreements negotiated this year new language which gives us greater rights in those specific instances when we find evidence of transshipment.

The United States has always held the view that when goods originating in one country are imported into the U.S. as though there were goods of another country, we have the right to make a "statistical correction" to the quota of the countries involved so that the goods are properly deducted from the quota of the country that actually made them and that the quota of the country that did not make them is typically recredited. The process of making this statistical correction involves receiving information on the circumvention from the U.S. Customs Service, consultations with the countries involved, as mandated by our current bilateral agreements and the Multifiber Arrangement (MFA), followed by a discussion and a vote by the Committee on the Implementation of Textile Agreements (CITA) to "charge" the quota of the country in which the good originated. As you know, CITA is chaired by the Deputy Assistant Secretary for Textiles, Apparel and Consumer Goods at the Commerce Department, Ms. Rita Hayes, and includes representatives from USTR, the State Department, the Treasury Department and the Labor Department.

However, despite this longstanding view of the U.S., our right to make these "statistical corrections" to the quota records was brought into question by a case heard by the Textiles Surveillance Body in Geneva regarding certain transshipment from Pakistan. The Textiles Surveillance Body or TSB, is the group charged with supervising the implementation of the Multifiber Arrangement. In light of this TSB case and this Administration's concern that transshipment problems were not being adequately addressed, new language was developed for inclusion in our bilateral agreements spelling out certain specific rights and actions to be taken when transshipment actions are found. Given the unusually large number of bilateral textile agreements scheduled to expire at the end of this year -- twenty-five -- if we are successful, we should be able to include these new provisions in agreements with the majority of our textile trading partners.

This new language makes five key changes from the language contained in our current bilateral agreements:

1. Right to Charge

First, the language clarifies our right to "charge" to the quota any transshipment coming from a given country, after consultations, even if our consultations with that country do not produce an agreement regarding the charges. This is the exact

issue that the Textiles Surveillance Body was unable to resolve in conjunction with the action brought by Pakistan. Pakistan had argued that the U.S. could not charge Pakistan's quota unless mutual agreement had been reached regarding the charges or the charges had been referred to and approved by the TSB before being made. The U.S. contends that agreement is not required by the MFA and that mandating that agreement be reached before taking any action only acts as an incentive for countries never to agree charges to their quotas, no matter how overwhelming the evidence that they were the country who made the goods in question.

2. Substantial Likelihood Language

The new circumvention language also takes steps to address the situation we often face where we have some information regarding possible transshipment but not all the evidence we would need to absolutely "prove" that transshipment has occurred. In those situation, we typically seek consultations with the country involved and ask them to provide us with certain records or information regarding the particular companies or shipments involved. All too often we receive nothing in response to our requests.

Specifically, our new language allows us to "charge" quotas where: 1) we have information demonstrating a "substantial likelihood" that transshipment has occurred, 2) we have asked the

foreign government for information or cooperation and 3) the foreign government has refused to provide such information.

3. Impromptu Plant Visits

We also have added language which was included in a few of our previous agreements giving us the right to make joint unannounced plant visits in order to verify the capacity of a given producer.

4. Actions Against Third Countries

The new language also adds the right to take action against the transit country through which the goods are transshipped if that country has allowed its quotas to be misused. The language gives us the right to establish a quota or to deduct from an existing quota for transit countries permitting themselves to be used a transshipment points.

5. Triple Charges for Repeat Offenders

Finally, the new language introduces the concept of penalties against repeat offenders. It would permit the U.S. to charge up to three times the amount of the actual transshipment provided: a) that the transshipment was of goods originating in a country against which charges for transshipment had been made in

the previous or current year; and b) the charges are applied equally in each of the three subsequent quota years.

We have added this tougher triple charging language because all of the other notions I have touched on involved simple "statistical corrections" to the quotas to reflect actual shipments. There are no penalties involved. Such corrections to the quota do not present a deterrent to countries to stop transshipping or to police transshipping. It is hoped that this new language will give countries an incentive to take their own strong actions against transshipping.

So far, we have reached agreement with the Czech and Slovak Republics, the Republic of Korea, Romania and the Republic of Egypt on this new anti-circumvention language. In addition, discussions have progressed with many of our Caribbean and Central American trading partners as well as Eastern European countries regarding this new language.

Textile Transshipment Task Force

The third activity that we have been taking to better address the problem of textile transshipment is the establishment of an interagency task force to look at what further steps should be taken or what current steps should be better coordinated in order to ensure that the Administration is doing all that it can

to combat transshipment.

The task force was formed at the very end of July. I am pleased to be co-chairing the task force along with Commerce Deputy Assistant Secretary Rita Hayes. The task force includes representatives from the Treasury Department, the U.S. Customs Service, the Justice Department, the Labor Department, and the State Department. The clear goal of the task force is to develop a comprehensive, multi-faceted approach to solving the problem of textile transshipment. While all of the departments and agencies represented on the task force have some jurisdiction over the issue, until the formation of the task force, there had been no interagency strategic development regarding how best to address this issue.

So far, the task force has made good progress. Each agency has made a number of suggestions for policy changes or prospects for improved action or coordination. We are currently in the process of examining each of the options suggested and will soon be forwarding along the recommendations of the task force. It is our hope that the work of the task force will represent the steps that we can take here at home or with U.S. companies to address the problem of transshipment, while the new bilateral anti-circumvention language and the position adopted regarding our bilateral agreement with China represent steps we are taking with our trading partners.

Conclusion

The Administration understands that our workers must be allowed to compete on fair terms with other countries. One of the key aspect to ensuring this fairness for American workers is the strict enforcement of our trade agreements. Textile transshipment violates these agreements and such violations cannot be accepted. Through actions with our trading partners, negotiations with the largest transshipping country, China, and the work of the task force to ensure that all facets of the government work together with a coordinated plan, we intend to take aggressive action to dramatically reduce textile transshipment. We look forward to working with you and the members of this Committee as we put in place these and other efforts to better enforce our textile trade agreements.

Mr. SPRATT. Ms. Hayes.

STATEMENT OF RITA HAYES, DEPUTY ASSISTANT SECRETARY FOR TEXTILES, APPAREL, AND CONSUMER GOODS INDUSTRIES, DEPARTMENT OF COMMERCE

Ms. HAYES. Thank you, Congressman Spratt. I am grateful for the opportunity to testify about transshipment and quota evasion and pleased to see the interest that this committee has taken. The nice thing about coming after Jennifer Hillman and Sam Banks is, as chairman of CITA, I can sort of summarize a lot of the figures and things they talked about previously.

Compared to drug trafficking, transshipment seems benign, unless of course your job is at stake. And 1.7 million Americans still work in textiles and apparel, more than any other sector of manufacturing. Last week, Customs estimated that Chinese apparel exporters are evading quotas and transshipping \$1.5 billion worth of goods into this country each year. Whatever the estimate, and I think we saw this earlier today with some of your questions on transshipment, they vary. But the bottom line is that these imports mean the loss of American jobs. But as important as they are, more than jobs are at stake.

Transshipment, evasion, circumvention, and fraud undermine the integrity of our trading system. For more than 20 years, textile and apparel imports have been restrained to some extent by quotas negotiated under the multifiber agreement. We have controlled access to our markets but not closed our markets—far from it.

The textile and apparel trade deficit rose to \$27 billion last year, second only to automobile products among manufactured goods. The United States imports more textiles and apparel goods in aggregate and per capita than any other country in the world. In return, we have the right to expect those who enjoy access to our markets to play by the rules; and transshipment flouts the rules of trade. That is why the committee for the implementation of textile agreements is dead serious about stopping this abuse.

We are also realistic about the difficulties, and I think we heard some of those this morning. Customs estimates of transshipment is just like Mr. Banks said, an estimate. No one knows the full dimensions of the problem, just as no one knows the actual volume of drugs illegally brought into this country. We have a hard count only on what we detect, and we are probably detecting just the tip of the iceberg.

In cases of transshipment, in the early cases, some of the made-in-China labels were cut out and new labels showing other countries of origin were sewn in. Parts of old labels could sometimes be seen, and occasionally the workers even failed to cut off the old label. Today, transshippers are smarter. Complete sets of counterfeit shipping documents are forwarded. False production books are made up. Front companies with hidden ownership are set up, and clothing is unloaded at transit points and repacked with new bills of lading showing the transit port as the point of origin.

Imagine being a Customs officer charged with detecting these illegal shipments. Each year 2.4 million textile and apparel shipments enter this country. You look at hundreds of shipments each day. The documents appear to be in order, and only a small per-

centage of the containers in the busy ports can be physically examined. I heard that the Congressman asked earlier whether it was 1 percent, and I think Mr. Banks said, no, it had been moved to 6 or 7 percent. But in any event, it is a very small percentage that can actually be examined. And so very seldom do we see that physical examination is enough to reveal fraud.

Even if there is strong suspicion that goods have been illegally transshipped, Customs must have proof that the goods were made in a country other than the declared country of origin before it can be charged against a quota. This requires tracking the paper trail of goods back to the real country of origin. It is not easy to obtain shipping documents for transport between one foreign port and another foreign port. Even when transshipment is documented and proved, Customs can only charge that one shipment, even though it may be similar to hundreds of other shipments whose source Customs has not tracked.

Under those conditions, odds of success favor the transshipper. Despite the difficulties, Customs has turned up enough transshipments to indicate that the problem exists and quite possibly to a greater extent than we all could guess. One of the chief offenders is China.

Over the past 2 years, China has been charged with transshipments valued at \$300 million. These charges consist of 35 million garments and 1 million kilograms of other textile products. China cannot claim that quotas we have agreed upon are too strict. China is our largest foreign supplier of textiles and apparel, accounting for over 13 percent of the United States imports. Its bilateral with the United States allows textile and apparel exports subject to quota to grow an average of 4 percent a year, more than any other major supplier.

In 1992, China legally exported \$4.6 billion in textile and apparel goods to the United States. Textile and apparel exports are the largest hard currency earner for China, and millions of Chinese depend on textile and apparel manufacturing for their jobs. So, one can understand the pressures behind China's transshipment without excusing them. China's economy is growing at a very fast pace. The growth is most in the special economic zones in China's southern provinces, where joint ventures in apparel are springing up and major investments are being made in their new factories. Because of expanding production, quotas in many categories are pressed to the limits. Chinese factories arrange to ship their goods under the unused quotas of another country.

Southeast Asia has a number of other countries that have enjoyed years of growth in their textile and apparel quotas. While their quotas were growing and their exports were expanding, their wage rates were rising.

Today countries like Taiwan and Hong Kong pay their apparel workers approximately \$4 to \$5 per hour, versus the 30 to 35 cents per hour paid to workers in China. Because of their relatively high wages, the Dragons of Asia are no longer as competitive in high-labor content work such as apparel assembly. This opens an opportunity for filling some of the quotas these countries still hold with low-wage products from China.

I have dwelled on China because Chinese transshipment are a major concern, but China is by no means the only offender. Customs has identified transshipments through 40 other countries. This is a global problem. Although we cannot quantify the problem, we know that it exists and that it involves a number of countries.

What can we do about it? The first step is to make our government realize the problem of transshipment and that we have done. The next step is to get to the bottom of the problem and come to a better understanding of it and how to combat it. And that we are doing also. The last step is to marshal the agencies of the Federal Government to bear down on this type of trade abuse, and we have begun to do that also.

For example, we talked about earlier this morning Operation Q-TIP, a joint venture between Customs and Justice, which was organized for a wide-scale investigation of transshipment. One object of this program is to learn more about textile production in different countries, so that Customs can judge if apparent imports from that country were likely to originate there. In fact, last June as a result of Q-TIP, the United States District Court in the Southern District of New York convicted Chinatex, China National Textiles, which itself is owned by the Ministry of the Light Industry in Beijing. A second trial resulting from Q-TIP will soon begin, and we hope to have others that will follow.

To focus on this problem specifically, the Clinton administration has formed a transshipment task force, which is made up of Commerce, Justice, State, USTR, and Treasury. Jennifer Hillman, the chief textile negotiator, and I cochair the task force.

The first action we took was to insist in the renegotiation of our bilaterals, that exporting governments cooperate in transshipment cases. New transshipment articles also allows us to charge the quotas of repeat offenders 3 times for each transshipment we find originating within their borders.

These articles would apply to the 40 countries with which we have bilateral agreements, most of which are members of the multifiber agreement. CITA, which I chair, has adopted a new transshipment policy to deal with countries that are not members of the General Agreement on Tariffs and Trade, GATT, or the multifiber agreement, or do not have a bilateral agreement with the United States.

Some 66 countries fall in this category. Under this new transshipment policy, when we have reasonable suspicion that goods have been transshipped, our government will ask the government of the country of origin to allow factory inspections. The government will have 15 days to respond. If the country agrees to inspection, imports from it can continue. A Customs investigative team will go out to inspect its factories. If that country refuses inspection, it will be given 10 days notice to answer and will have a chance to comply. If they still refuse inspection, a notice of embargo will be published in the Federal Register to be effective within 30 days.

At any time during this 30-day period, the embargo will be suspended if the country consents to inspection. Since establishing this policy, CITA has voted to invoke it against five countries. Cables were sent to our embassies to serve the notification. To date, all

have agreed to cooperate. Just last week, CITA agreed to invoke this policy against another country.

In the last 3 years, Customs teams have been sent to 32 countries to inspect factories and to see if imported goods claimed to have come from these countries were in fact made there. Out of the 32 teams dispatched, Customs found evidence of transshipment in 27 cases. There is a healthy debate about the problem of transshipment among everyone involved, but almost everyone agrees on this, Customs needs all the help it can get.

Drug smuggling, money laundering, arms trafficking, high-tech monitoring—Customs has had its hands full of a long list of priorities and priority programs. Transshipment is just another major task for Customs to take on, and the inspection and investigation required is labor intensive.

Mr. Banks testified earlier, and some questions were asked about technology. Technology can help somewhat. The electronic visa system, better known as ELVIS can help deter counterfeiting of visas by having the information transmitted directly from the export control authority in the country of origin to the Customs Service, the U.S. Customs Service; but the effectiveness of ELVIS is limited because the exporting government may not know itself whether the shipment was entirely or partially produced somewhere else.

So that we can all work together and more effectively, Customs and CITA have entered into a special MOU, memorandum of understanding. Under this memorandum of understanding on textile transshipment, Customs will furnish CITA information on a monthly basis which will include advising the chairman of CITA on significant developments and investigations of quota evasion. Customs will also report each month on cases involving the entry of false country of origin on Customs documents and the action it will take so that CITA may use the information to charge or reduce quotas or impose other restraints, and presenting much of the same pertinent information to foreign countries involved and assisting CITA in consultations with these governments.

Commerce, of course, will keep supporting Customs as we have in the past. The staff and Office of Textiles and Apparel have participated in Customs investigations and have accompanied many of their investigative teams on factory inspections.

Having tightened our bonds with Customs, CITA now wants to strengthen its ties with Justice. Our transshipment task force is developing recommendations for a closer working relationship with Justice.

This administration looks upon transshipment with serious concern, and we are taking action to stop it. There is no single or simple solution. But in the last 5 months, since I have been chairman of CITA, we have faced this problem squarely and have taken the following steps: We have developed a new transshipment policy with countries with which we do not have bilateral agreements; we have developed tough fraud and circumvention language to be part of the new bilaterals that we are negotiating and have included it in all the bilaterals renegotiated to date; we have entered into a well-crafted MOU with Customs to coordinate our efforts and to improve data exchanges; we have made quota charges and applied our new transshipment policy and taken a strong position in re-

negotiation of the China bilateral, all of which showed resolve; and we have founded a textile and apparel transshipment task force, which will issue shortly a set of recommendations to stiffen enforcement still further.

Our goal is to make everyone involved in transshipment—importers, exporters, the source country, the transit country—think twice, and, on second thought, decide the risks have become too great and, if caught, the penalties for violation are too severe to be worth any gain.

Obviously, our methods of detecting transshipment can stand improvement; but to deal with the problem effectively, we have to rely on deterrents which means that our rules have to be strong and our procedures have to be effective. It also means when fraud and invasion is found, it has to be sternly dealt with.

Taking action against this sort of illegal activity is in line with the overall policy of this administration. As President Clinton said last week, one goal of his administration is economic security for all who work and play—who work hard and play by the rules. This applies to ending transshipment and other abuses which are not by the rules.

Thank you so very much.

Mr. SPRATT. Thank you very much.

Mr. Richard.

STATEMENT OF MARK M. RICHARD, DEPUTY ASSISTANT ATTORNEY GENERAL, CRIMINAL DIVISION, DEPARTMENT OF JUSTICE

Mr. RICHARD. Mr. Chairman, with your permission, I would just submit my statement for the record.

Mr. SPRATT. Without objection, it will be made part of the record as submitted.

Mr. RICHARD. I would like to summarize a few points if I may.

Mr. Chairman, I am a Deputy Assistant Attorney General in the Criminal Division of the Department of Justice, and among other duties assigned to me is one of overseeing our international enforcement effort. In that regard, I am particularly familiar with the Department's criminal enforcement efforts in this area.

I welcome the opportunity to describe our role at the Department of Justice in supporting efforts to curb illegal transshipments of textile and apparel merchandise and in assuring prosecution of meritorious cases developed by the Customs Service, Department of Commerce, and other government entities.

Let me begin categorically by saying that the Department of Justice is dedicated to aggressive international trade fraud enforcement.

Typically, Customs agents conduct criminal investigations, often coordinating with U.S. attorneys' office during the course of the investigation, in order to obtain legal advice, issuance of search warrants, and grand jury proceedings. Eventually, Customs Service agents provide the results of their investigation to the appropriate U.S. attorneys' office with a recommendation for or against prosecution.

Although we at main Justice in Washington generally do not directly prosecute these cases, we do have an important role to play

in the area, and we do play it in an active fashion, utilizing several of our divisions and sections. The Criminal Division, for example, provides policy guidance, coordination of efforts, oversight, and, where needed, supplemental resources in order to assist U.S. attorneys' offices in prosecuting specialized cases.

The Criminal Division's General Litigation and Legal Advice Section was involved very heavily in the multidistrict coordination of search warrants in the Q-TIP investigation and prosecution.

The Criminal Division's Office of International Affairs assists in transshipment investigations and prosecutions which require obtaining evidence from foreign governments or in other areas where it is necessary to respond to issues of extradition or other issues involving international law.

The executive office for U.S. attorneys works closely with the Customs Service and the U.S. attorneys in order to assist in providing joint legal and prosecution training.

As indicated by Commissioner Banks, we are embarked on a program to upgrade the training of both the prosecutors and the Customs agents in this area; and we hope that that will enhance our effectiveness in responding to this problem.

I also want to briefly express the gratitude of the Department for being included in the textile transshipment task force. While the Department of Commerce and Office of Trade Representative created and cochair the task force, the Department of Justice appreciates the opportunity to participate in this initiative.

The task force has wisely recognized the interrelationship of administrative, civil, criminal, and international mechanisms which may deter transshipment violations. And as representatives here have already indicated, the Justice Department has been eager to participate in interagency activity aimed at achieving administration goals.

An example of interagency cooperation and the important role of the task force is in the use of information developed in criminal investigations to facilitate quota adjustments responsive to these violations.

I would say, Mr. Chairman, members of the committee, that this is a particularly sensitive issue because there are inherently a variety of restrictions that may affect our ability to share freely information derived during the course of criminal investigations. Working through these potential obstacles is one of the virtues of operating in the interagency context and enables us to deal effectively with these difficult issues.

To further facilitate the prompt and proper sharing of information, the Justice Department has under consideration a program which would designate Commerce or Trade representatives as liaison officers to key U.S. attorneys' offices. That would be in order to ensure that investigative information regarding textile shipments is made available to the Federal interagency committee as early and as quickly as possible. Our preliminary discussions with prosecutors in these key offices has indicated strong support for such a concept.

We are also working with other task force agencies in order to evaluate potential consequences of a wide range of possible statutory initiatives, including but not limited to, creation of a separate

transshipment offense, modifying the elements of existing violations, and enhancing existing sanctions for violations.

In conclusion, I believe that the increased investigative activity of the Customs Service is already yielding significant textile transshipment case referrals and, with the support of the Criminal Division and the U.S. attorneys' offices, important prosecutions.

Ongoing cooperation between the Office of the Trade Representative, Department of Commerce, Department of Treasury, and the Customs Service, as well as the Department of Justice, should lead, in our judgment, to better coordination in the application of criminal, civil, administrative, and international remedies to quota revision schemes and thus to the augmentation of deterrents to illicit textile transshipments.

Mr. Chairman, that concludes my summary. I would be glad to answer any questions.

Mr. SPRATT. Thank you very much, Mr. Richard.

Mr. RICHARD. Thank you.

[The prepared statement of Mr. Richard follows:]



Department of Justice

STATEMENT

OF

MARK RICHARD

DEPUTY ASSISTANT ATTORNEY GENERAL

CRIMINAL DIVISION

BEFORE

SUBCOMMITTEE ON COMMERCE, CONSUMER AND
MONETARY AFFAIRS

COMMITTEE ON GOVERNMENT OPERATIONS

U.S. HOUSE OF REPRESENTATIVES

CONCERNING

ILLEGALLY TRANSSHIPPED TEXTILE AND
APPAREL MERCHANDISE

PRESENTED ON

OCTOBER 5, 1993

Mr. Chairman and members of the Committee --

My name is Mark M Richard. I am a Deputy Assistant Attorney General in the Criminal Division of the Department of Justice.

The Department of Justice is dedicated to effective international trade fraud enforcement, including the prosecution of quota evasion schemes involving the transshipment of textile and apparel merchandise. While the representatives of the United States Customs Service, the lead investigative agency for textile transshipment violations, are most qualified to discuss the nature and scope of these violations, I welcome the opportunity to explain the role of the Department of Justice in supporting Customs Service efforts, and in assuring the prosecution of meritorious cases which the Customs Service or other agencies, such as the Department of Commerce, develop.

Textile transshipments and other quota evasion schemes are handled by the Department of Justice structure primarily through United States Attorneys' Offices. Customs agents conduct criminal investigations, often coordinating with United States Attorneys' Offices during the course of an investigation for legal advice, the issuance of search or seizure warrants, and grand jury proceedings. Eventually, Customs Service agents present investigative results to the appropriate United States Attorney's Office with recommendations for prosecution.

The Criminal Division of the Department provides policy guidance, oversight, and specialized support. For example, the joint Justice-Treasury Economic Crime Council previously designated international trade fraud as an "area of special emphasis" for federal law enforcement. That body then communicated its decision that such violations merited special attention to both Customs investigative components and Justice prosecutors. Such a designation is intended to convey to United States Attorneys the relative importance of these types of cases.

The Criminal Division's General Litigation and Legal Advice Section also plays a role in coordinating United States Attorneys' Offices' efforts where warranted by the facts. For example, that Section was involved in the multi-district coordination of search and seizure warrants in the Customs Service "Q-TIP" (Quota Transshipment Importation Practices) enforcement initiative. That effort involved bringing together some 14 United States Attorneys' Offices to move together in a coordinated fashion in the execution of search and seizure warrants across the country. In addition, that Section of the Division also assisted in the staffing of one of the resulting criminal cases from that continuing effort, after a United States Attorney's Office requested the assignment of a Criminal Division litigator with international trade fraud prosecution experience. In this regard, the Criminal Division is prepared to resolve these issues as they arise.

The Criminal Division's Office of International Affairs participates in transshipment investigations and prosecutions which require assistance from foreign governments, involve entities of foreign governments in domestic criminal prosecutions, or raise issues involving international law or criminal justice treaty obligations.

The Department's Civil Division also plays an important role in responding to illicit textile transshipments. Upon referral by the Customs Service, the Civil Division institutes suit to collect civil penalties in the Court of International Trade. While most civil penalties are resolved at the administrative level or in connection with a criminal disposition, the commitment of the Civil Division to move aggressively acts to encourage resolution of the civil aspects at the administrative level.

Of additional importance, the Executive Office for United States Attorneys is also working with the Customs Service and the United States Attorneys' Offices to provide joint agent and prosecutor training, to better equip personnel to handle complex transshipment investigations and prosecutions.

As the United States Trade Representative, Department of Commerce, and Department of Treasury recently have intensified their efforts to deter textile transshipment, the Department of

Justice has been an eager participant in interagency efforts to achieve their goals. We were pleased to be included in the Textile Transshipment Task Force, to which the Chairman referred in his invitation to today's hearing.

While the Trade Representative and Commerce witnesses are most qualified to discuss the activities of the Task Force, since those offices created and co-chair the body, I can assure the Subcommittee that the Department of Justice is appreciative of the opportunity to participate in this planning effort. The Task Force has wisely recognized the interrelationship of administrative, civil, criminal, and international mechanisms which may deter transshipment violations.

In this regard, information developed in criminal investigations may at times facilitate quota adjustments responsive to the same violations. However, any transfer of sensitive investigative information from the criminal justice process must be conducted consistent with legal and strategic barriers to disclosure. For example, there may be legal barriers to dissemination of information acquired by grand jury proceedings, through confidential informants, or through Mutual Legal Assistance Treaty (MLAT) requests, which cannot routinely be transmitted.

The Department of Justice has recommended that information that can be legitimately disseminated to Commerce or U.S. Trade Representative personnel be handled through liaison officers they designate and assign to work with key United States Attorneys' Offices. This process would ensure that when transshipment investigative information becomes public by virtue of court filings or public testimony that it is promptly made available to the federal interagency Committee for the Implementation of Textile Agreements (CITA). That information will then be utilized in charging shipments to the appropriate quotas pursuant to bilateral treaty provisions. Our preliminary discussions with prosecutors in those key offices brought forth strong endorsements of the concept, as a means of providing an additional sanction for transshipment offenses.

The Department of Justice is currently working with the other Textile Transshipment Task Force agencies in reviewing various statutory changes that have been suggested from various quarters to improve the legal arsenal available against such offenses. These include, but are not limited to, creating a separate criminal transshipment offense, modifying or clarifying the knowledge and intent elements in existing statutes, and imposing more severe sanctions for existing violations. Thus, I believe that it would be premature to offer any definitive comment today upon the "adequacy of the penalties in deterring

such shipments," a topic raised by the Chairman in his letter of invitation.

In conclusion, I believe that the increased investigative activity of the Customs Service is already yielding significant textile transshipment case referrals and, with the full support of United States Attorneys' Offices and the Criminal Division, important prosecutions. Ongoing cooperative efforts of the Trade Representative, Department of Commerce, Department of Treasury's Customs Service, Department of Justice, and other participating agencies should lead to better coordination in the application of criminal, civil, administrative, and international remedies to such quota evasion schemes, and thus to the augmentation of deterrents to textile transshipments.

Mr. Chairman, this concludes my statement. I would be glad to answer any questions from you and other members of the Committee.

Mr. SPRATT. Let me go to one of the points you raised and one of the points that has surfaced throughout the hearing, and that is the adequacy of data and the timely access to data.

Customs is the point of origination when it comes to data. If they suspect a criminal violation, I suppose at some point they engage the Justice Department or the U.S. attorneys' office. They have their own enforcement people. But CITA cannot act until it has the data, yet frequently this data is commingled with grand jury proceedings and confidential investigations that are conducted both by Customs and Justice, U.S. attorneys' office, maybe even the FBI.

Is this a major problem getting the data developed and produced to the civil enforcement authority, CITA in this case, so that they can have the data to act upon it, charge back quotas in a timely manner?

Let me first ask Ms. Hillman and Ms. Hayes, if this is a problem with enforcement?

Ms. HAYES. One of the problems, I think I mentioned it earlier, with having this MOU with Customs, is we would have a better understanding of what they could share with us. And one of the new proposals in the MOU is Customs will meet with us on a regular basis and let us know new cases that are ongoing, cases in which they may not be able to give us actual physical paperwork of charges, but at least can provide us information. We get information from importers. We get information from a lot of different sources that we can bring together.

So you are right in asking the question. The difficulty is that a lot of times there are ongoing investigations, and this is something we can't share with the other country.

Ms. HILLMAN. I think there is a threefold problem. I think we have gone a long way to trying to address it with this memorandum of understanding between the CITA agencies and Customs.

One of the problems is just the timeliness of the information. Obviously, from the quota perspective, we would like the information as soon as possible so that the charges can be made to the quotas, and the Customs and the redelivery notices can go out before the goods are actually out in the stores and being sold.

So part of it relates to how quickly we get the information. And there will always be an inherent tension between the finishing up of a complete investigation and when we get the actual information at the CITA level.

We believe that this memorandum of understanding will go a long way toward having that information flow take place on a more timely basis.

The second aspect of it comes from a trade negotiator's perspective whereby, where we do find evidence of transshipment, we are required by the multifiber arrangement and by our bilateral agreements to sit down with the country involved and say to them, we think you transshipped these goods and here is the evidence we have to show you that we believe you have transshipped these goods and here is why we believe you really made these goods and why we would like to go ahead and charge your quota. So we run into a second issue of what kind of information and on what basis can we, as trade negotiators, share that information with our trading partners.

Most typically this is worked by a Customs to Customs or at least a law enforcement to law enforcement arrangement between these countries. But, again, there is an ongoing tension between how much information we feel comfortable sharing with our trading partners, particularly when we believe a company in that country has been engaged in an illegal activity.

Again, we feel we are making very good progress in terms of relationships between Customs and the CITA agencies to make sure that Customs is prepared to provide a sufficient level of information that we can go ahead with these consultations. But that is the second issue.

Then the third issue gets into this: The nature of the kind of investigation where, when it is a civil kind of a case, we feel the information flow can go fairly quickly and fairly fully.

It gets a lot more difficult when it is a criminal investigation. Very understandably the levels of confidentiality of the information, the need to protect things that might or might not be before a grand jury is a very real problem, and in terms of how much information flow there is going on.

And I think we believe that it is important that we go ahead with these criminal prosecutions. And that is simply a tension we are going to have to live with.

Mr. RICHARD. If I may just add, Mr. Chairman, the problems associated with conducting parallel proceedings are not unique to this area. They do create difficult issues, legal issues as well as practical issues, in the context of investigating these cases.

In my experience, the best way of confronting them is through dialog, because they come down to a case-by-case evaluation of our ability and an evaluation at that time of whether or not we are in a position to share the information.

Unfortunately, these cases, given the nature of them, are difficult and time consuming to put together; so, frequently you do have protracted investigations and protracted grand jury proceedings, during which time information is generally not on the public record and is not readily capable of being disseminated.

So there is a certain amount of difficulty inherent, if you will, in the process; but I would suggest that, as we maintain open dialog and open channels of communication to the extent that we can both legally and tactically provide the information in a timely way, it is our intent to do so.

Mr. SPRATT. Fine.

We discussed earlier with Mr. Banks the problem of knowing enough about the 40-odd countries with whom we have bilaterals and the 60-odd other countries that regularly ship textile and apparel products to us to judge whether or not incoming shipments are likely to have come from those countries, the ostensible country of origin. In connection with NAFTA and Mexico, Customs has already begun building a data base to do kind of an ongoing regression analysis to see if incoming trade flows compare with past trade from numerically identified manufacturers.

Do you see this as having some possibility, also, for adding on as, say, an appendix to our bilaterals, a possibility of requiring the countries with whom we agreed to submit to us the key information, give us the initial input for that kind of data base so that we

can apply the same analysis to ferret out transshipment at the source?

Ms. HILLMAN. I guess my response would be, again, it is an idea that is well worth our looking at. It, obviously, varies from country to country how likely you are to be able to get information that is really usable.

Many of the smaller countries which have a limited number of manufacturers with whom we have very good cooperative relations we could probably build a very good data base.

With other countries, it is going to be very difficult because the sheer number of manufacturers who actually make apparel products is quite large. Many of them continue to have a very significant amount of capacity to produce; but in many countries, wage rates have gone high, such that they are not actually using all of that capacity. A part of the question would be how useful is this data if we know that the capacity still exists if, in fact, they are not actually manufacturing—they could still be sending a lot of goods indicating they were made in this country when, in fact, they were not.

So part of it would also depend on how good our data would be. It is certainly an idea well worth exploring. We have talked internally about how we could put together such a data base, whether we could accumulate data and whether we could get adequate amounts of cooperation from our trading partners.

Again, there, I think, the answer is mixed. Some, I think, would—again all of those that have agreed, for example, to put manufacturers ID numbers and manufacturers information on their visas—are likely to be very cooperative.

With other countries, we have not been able to work out as good a relationship in terms of sharing information as with some countries. But it is certainly an idea that is worth our continuing to pursue.

Mr. SPRATT. You have touched on a point there that has also been touched upon in earlier testimony, and that is certain nations over past years have accumulated substantial quotas in certain categories which are not fully used up each year; and, consequently, that opens up both an opportunity and a temptation to engage in some kind of transshipment scheme so that a low-wage country can appropriate those unused quotas and ship under the quotas of that particular country.

Is one of the solutions to the problem, then, simply absorbing, taking up, retracting these unused quotas which overhang in the market?

Ms. HILLMAN. I think you have touched on a very important problem and a very, if you will, large difficulty with the multifiber arrangement.

As you know, the multifiber arrangement was set up as an orderly growth mechanism. As a result of the MFA, basically, quotas can only grow. There is not a provision in the multifiber arrangement that calls for the reduction in quotas. It was designed as a growth system. It was not designed as a way to reallocate quotas.

As a result, the only way in which we can get quota reductions is to simply ask a country voluntarily to give us back their unused quota. I will tell you from having started down that road that very

few countries are willing to simply give it back. Many say they may have aspirations down the road; they have no legal obligation under the multifiber arrangement to give it back. Many of them have already allocated the quotas internally within their country.

So for them, it would be a very major change internally to very real economic interests in their country if they were to give back quotas.

Mr. SPRATT. Is there some way we could establish a penalty upon transit countries who allow their country to be used as, ostensible, "country of origin?" Penalize them?

Ms. HILLMAN. In this new bilateral language for the first time is the notion that we can charge both the country of origin and the transit country for the same shipment if we find transit countries that are allowing their quota to be abused. We have the right, if they do not already have a quota, to establish one; if they do have a quota, to deduct from their quota, which is the first time we have really said we are going to go after transit countries if you are allowing your quota to be abused.

That is one way in which there could be at least a temporary reduction in the quota.

Clearly, the other thing we are trying to do in the overall context is to look at this issue of whether there could be a multilateral way to address the issue of these large amounts of unused quota.

If there isn't a way to address, as a result of the multifiber arrangement discussions or anything else, this issue of how do we get rid of all of this unused quota—again it is a very, very difficult issue. It is not a concept that most countries that have been a party to the MFA would agree with. They simply would say that they have the right to keep that quota.

Mr. SPRATT. Several of the witnesses on the next panel will suggest that this problem needs a new solution. And one solution would be import licensing in advance of shipment. We have ELVIS which at least approaches something like that. It is advance notification of visas being issued.

Is ELVIS applicable across the board? I think it is only used in what? Singapore?

And does it hold out the same kind of solution as import licensing?

Mr. BANKS. I don't think so. I don't think it would be exactly the same thing. ELVIS is only up and running with Singapore where it is currently testing with China, and it is going to be a while before we get everybody up because this is really a voluntary effort.

Mr. SPRATT. This does give us advance notice of incoming shipment?

Mr. BANKS. Actually we get advanced entry information and advanced electronic manifest information today, but I think the licensing might try to achieve something slightly different than that.

I think I would need to understanding the licensing system better to really be able to answer your question, Mr. Chairman.

Mr. SPRATT. We have got a couple of witnesses who will lay out the details. Each one has a different approach to it.

Is there some way that we can require the importers, the shippers, to provide more information on the import declarations and on the bills of lading that will both make your job easier and also

make prosecution of analysis entries more feasible when the case occurs?

Mr. BANKS. I think that is one of the things that we are looking at in the transshipment task force. Yes, sir.

Mr. RICHARD. The more specificity on the document obviously in terms of potential prosecution, the easier it becomes.

Where there is ambiguity and opportunity for interpretation, vagueness, you have potential defenses arising to any assertion that the submission was in violation of some felony false statements statute.

Mr. SPRATT. Are you comfortable with the level of knowledge now among assistant U.S. attorneys in key port cities?

I know we can't disseminate this information to every U.S. attorneys' office, but in those key port cities where there are many potential violations, do we have the knowledge of applicable law and trade practices as well, not just among the attorney staff but among the accounting and audit staff, for expert witnesses to vigorously go after these cases?

Mr. RICHARD. I would be inclined to say probably not. We have been moving, though, with Customs, to upgrade our familiarity with this area. It is a particularly technical one.

What we hope to do is develop in the key districts resident expertise which will link up with the Customs, Commerce, and other government entities that have the expertise to ensure that we continually maintain a minimum level of confidence to handle any of these cases that come across.

But in answer to your question, we still have a long way to go; but we are moving in that direction.

Mr. SPRATT. Mr. Horn.

Mr. HORN. Thank you, Mr. Chairman.

Ambassador Hillman, I was interested in your comments on page 7.4, actions against third countries and the number of things you wanted to do to them.

What is our leverage on them? Must we have a bilateral agreement with them to impose some of these penalties? Or can that be done without a bilateral agreement with the transgressor, if you will?

Ms. HILLMAN. Basically, the countries would fall into a number of categories. With countries that are a member of the multifiber arrangement, with whom we have a bilateral textile agreement, we can take action, again, provided we negotiate the kind of language that I am talking about. We do not currently have it in our bilateral agreements. We are seeking it in those countries with whom we have a bilateral textile agreement. That is some 40 countries. This year we have agreements expiring with 25 of them. So if all goes well in these negotiations by the end of this year, we will have the language that I described in place with 25 countries.

Then, as Ms. Hayes described, we have a new policy for countries that are not a member of the multifiber arrangement and not a member of the GATT whereby we have said if we believe there are suspicious transshipments—suspicious goods coming out of your country—and typically this involves a country who has never been a textile or apparel supplier—and all of a sudden we will see large shipments of textiles or apparel coming from a country that we

have never thought of as capable of producing large volumes of textile and apparel, our new policy with those countries is to say we think there is something suspicious here; we would like to come in and inspect your plants; we don't think you are capable of making this volume of goods; we think you are transshipping; we want to come in and inspect; and if you ultimately refuse and will not let us in, that we then will have the right ultimately to embargo your goods because we don't think you are actually making them.

So it depends on which kind of a country you are talking about in terms of whether they are or are not a country with whom we have a bilateral textile agreement.

Mr. HORN. Would a simple way to solve this be—or maybe you already have the authority that you are authorized, Customs in this case, but under the general trade policies, to impose a very restrictive tariff on goods that have manifests that are off as to their country of origin and that you simply let them in with this unbelievably high tariff and see if they want to pay it or ship the products back? What can we do there?

Isn't that easier to administer than the quota?

Ms. HILLMAN. The answer, it would be arguably easier to administer; but we could not do it. Our tariffs are generally applied under the General Agreement on Tariffs and Trade on what we call a most favored nation basis which requires us to apply tariffs uniformly to all nations that have MFN status.

So we would have a certain column duty rate that must be applied to all MFN countries.

Mr. HORN. But not if they are lying?

Ms. HILLMAN. Again, the issue of the origin of the goods—again, theoretically, the tariff would be the same whether the good was made in China, Malaysia, or Singapore.

Theoretically, the tariff on that item, whatever it is, would be a set percentage number regardless of the country of origin.

The country of origin is really relevant to the issue of quotas again because it is the quota that determines the restraint on it. And each country is allocated a certain amount of quota for a given product. So it is really the quota that is being violated by violations connected to the country of origin.

So the general way in which the GATT would work and the multifiber arrangement would work is that the penalty, if you will, for violating the country of origin rules ought to fall on the quota side not on the tariff side.

Again, you are absolutely right, that it would be easier to do if it could be done on the tariff side. But I think it would violate the general notion of the General Agreement on Tariffs and Trade and most favored nation status and again arguably gets you outside of this multifiber arrangement system which is a quota-based system.

Mr. HORN. We are still subjected to nontariff barriers in some countries with which we deal, right?

Ms. HILLMAN. Correct.

Mr. HORN. Why don't we have some nontariff barriers and inspect and inspect and inspect and inspect? It could take years, and they will rot on the dock.

Ms. HILLMAN. I don't know whether Mr. Banks wants to comment.

Mr. HORN. Are we just pussy cats?

Mr. BANKS. We are accused of doing that today, sir.

Ms. HILLMAN. Clearly, that is among the many things that we are saying to our trading partners, as a result of all of this, is: Look you must cooperate. This is a very serious problem. We are going to take it very seriously, and we are going to insist on cooperation from our trading partners. And if you do not cooperate, there is a whole series of things that we can do, among them is charge of quotas; among them, if you are a repeat offender, triple charge. Among the things we were proposing for China is an actual reduction for their quotas. Other things can be done on the Customs side. We can do a lot stronger things in terms of import controls and things.

So there is a whole range of things that we are saying to countries we are prepared to do if we do not get cooperation from them.

Mr. HORN. Well, what are some of those things you are prepared to do if we do not get cooperation?

Ms. HILLMAN. Again, on the quota side, we have made it very clear that we are prepared to take much more aggressive action in terms of charging quota, charging more quota, charging triple the quota, and, in the instance of China, considering rollbacks, actual across-the-board cuts in the quota which, for China, would be very substantial in terms of volume amount and dollar amount if they do not comply.

Then, in the negotiations process itself, we have Customs—you know Customs representation that go into the issues on the Customs side.

Mr. HORN. Mr. Banks.

Mr. BANKS. Yes, sir. Usually we single this out based on a specific importer or a specific manufacturer that we have had continued problems with.

And to be candid with you, they are subject to repeated inspections and examinations. And that is an expensive process. Every time a carrier gets hauled off to one of our examination sites, it is typically \$300 to \$400, too, because there is actually labor charged to cover the containers so we can do the examinations.

The other thing that can happen is we can get a shipment in and we can ask for production information and that can delay a shipment; and delays are critical to the textile industry, the import community.

At the same time, we have to have good cause because we do get a lot of pressure from the other side of the equation, that we are impacting U.S. businesses that are trying to compete internationally so it is something we use very judiciously.

Ms. HILLMAN. The other thing that we do, again with our trading partners, is, if we found a particular company or particular exporter in a given country, again when we go to present evidence saying we think this particular firm has been transshipping, we ask for them to revoke quota from that country, to revoke export licenses from that company, to, in essence, shut them down.

And we want very specific evidence that the government has, in fact, done that; that, when we find a specific company involved as part of this consultation over the transshipment issue, we insist that these governments take very strong action against their exporters.

Again, we have mixed results: Some countries do a good job, and others do not.

Mr. HORN. Would you guess that we have had 100 cases like that in a fiscal year; 10 cases?

Ms. HILLMAN. No, it is not that high.

Mr. HORN. Ten? In other words, it is a toothless tiger?

Ms. HILLMAN. Because, again before we can even go to this step of beginning these consultations, we have to have a fairly high level of evidence showing who made the goods, when they were shipped, what third country did they go to, who sewed in the new labels, how did they get them, and what documents did they enter into.

Unless we have that entire, sort of, chain of evidence or very close to it, we cannot even begin the process of consulting with these countries in order to make these kind of allegations and charges.

So the initial burden of collecting enough information to begin the process is a fairly tough one, which is why the number of consultations and the amount of goods that we have actually charged the quotas is a very small percentage of the total volume that we think is, in fact, transshipped.

Mr. HORN. China seems to be the main transgressor here. How much of these goods that are transshipped illegally in terms of point of origin come from the so-called infamous Chinese prisons, and can we tell? Do we have any way of telling?

Mr. BANKS. Well, on the forced labor issue, there are a few things—there is at least one thing that I know of that is a textile product, it was socks, but most of them have not been textile products, to the best of my knowledge. I think we have 18 detention orders on forced labor products.

Mr. HORN. OK.

Mr. Richard, my last question goes to you. Does the Department of Justice, and the Criminal Division in particular, know the number of cases referred to the U.S. attorneys around the country in the port cities, airport or port cities, and where we stand versus referrals from Customs versus indictments brought? Do we have any data such as that?

Mr. RICHARD. Our data collection system, sir, is based on the number of times a particular statute is used. So we will have data, for example, on how many times 18 U.S.C. 542 was used. You cannot necessarily conclude, however, that that is a transshipment case.

I would suggest that, at the present time, Customs would have a far better accurate picture. We could certainly acquire that.

Mr. HORN. Could we insert it into the record, Mr. Chairman.

Mr. SPRATT. I think it would be very useful if you could develop that information without an inordinate work to have it for the record.

Mr. HORN. Let's have Mr. Richard and Mr. Banks work it out. I am just curious the degree to which Customs brings charges before an assistant U.S. attorney somewhere—to what degree are those pursued in, say, the last fiscal year? Fifty percent of the time? Eighty percent of the time? Ten percent of the time? Whatever.

Mr. RICHARD. We can develop that data for you.

Mr. HORN. If you could do it by U.S. attorneys' offices, I would appreciate knowing that.

Mr. RICHARD. Fine.

Mr. SPRATT. Cases referred versus indictments returned?

Mr. HORN. Right.

And if you want to really get extra special, how many did we convict? Effectiveness?

Mr. RICHARD. We certainly have the data in connection with the Q-TIP operation, but I don't want to suggest that that is the total universe of cases that are involved. So I will work with Commissioner Banks, and we will submit it for the record.

Mr. HORN. Great.

[The information can be found in appendix 2.]

Mr. SPRATT. Mr. Green.

Mr. GREEN. Thank you, Mr. Chairman.

The line of questioning up until now has been—and I appreciate the double charging and triple charging—about the quota. The problem is if they just transship them, you know it doesn't matter, we can lower their quotas all we want; but if they produce it in Sri Lanka and ship it over here and we don't care if it doesn't have any impact on them and it comes back to the United States importers, I guess, of those products and the ability to—and, again, I would like to see the information on the indictments and the convictions on the United States imports, we know they are here, or their retailers are here—I know we don't get into international law when we are talking with a retailer here in the United States. They are the ones actually importing the product.

There is some testimony—and we will hear it later—that a lot of the retailers or the importers actually can follow. They are sophisticated enough to know because of the quality and the price of the merchandise that they are the ones they know very well if it was manufactured in China or where ever else and then transshipped to someone.

It seems like that is where our enforcement mechanism should be aimed at. And if each of you could comment on that, because I know each of you have a part of that.

Ms. HILLMAN. I will comment from the perspective of the transshipment task force. This is an issue that we are looking at very carefully.

As you may know in the NAFTA, we created a little bit of a different system whereby both the importer and the exporter are, in a sense, signing statements that they are affirming, swearing, that the goods meet the rule of origin under NAFTA, which means that they must meet a very strict test of having been made in Mexico, or made in the United States, or made in Canada.

And when those goods are shipped, there is a fairly high burden of proof, if you will, on the importer and exporter to know that those goods and to swear and affirm that those goods meet the rule of origin and a fair amount of liability adhering to both the importer and the exporter if, in fact, the goods did not meet the rule of origin.

One of the many things that we are looking at is whether, again, we can step up the volume of information and the degree to which

an importer must be viewed to know from whom they buy. I mean to be taking on a clear responsibility to understand that when they say those goods were made in Malaysia that they, again, know or have reason to know that they were, in fact, made in Malaysia and how much of that burden we can shift in that direction is clearly one of the items that we are looking at. We did it in the NAFTA.

I think people are fairly confident that that change in burden, to show that you are swearing when I say these goods are made in Mexico, I swear they are made in Mexico, and I understand that I am liable if they are, in fact, not made in Mexico, was an important change and one that we are going to continue to look at.

Mr. GREEN. There is no requirement now that an importer make that statement? NAFTA is breaking new ground?

Ms. HILLMAN. Right. Now the burden would be more on the U.S. Customs Service to prove that the importer knew or should have known that the goods were not made in the place that they say they were made. Under NAFTA, it changes.

And so it is a question of who is really responsible for having that body of knowledge and where the burden of proof lies. And right now, most of it from other countries, to meet general rules of origin for other textiles and apparel falls on U.S. Customs to prove that that importer knew or should have known that the goods did not come from where they said they were.

Mr. SPRATT. Are you saying that under NAFTA there will be a stricter standard imposed upon the importer?

Ms. HILLMAN. Correct.

Mr. SPRATT. Almost a strict liability standard?

Mr. BANKS. I don't know if you would call it a "strict liability." That really gets into a legal definition. But there is an obligation for this exporter certificate of origin.

Mr. SPRATT. You have a duty to inform yourself; and if you undertake to sign this, are you also assuming a duty to inform yourself as to whether or not what you are representing is true in fact?

Mr. BANKS. Yes. That is precisely what the exporter certificate is designed to do. NAFTA, in some ways, is almost a prototype of where we want to take some of these things.

Mr. SPRATT. Excuse me, Gene. I am sorry to interrupt you. I wondered if I could get a clarification.

Does that mean then that Customs has to show, the prosecution has to show that you failed in your duty, were negligent, what is the standard of proof?

Mr. BANKS. I think we would still have to show negligence.

Mr. RICHARD. I mean, for a criminal prosecution, you are not talking of a negligence standard; you are talking about a willful standard that—

Mr. SPRATT. So we are back to some sort of—

Mr. RICHARD. You are talking a whole spectrum of sanctions. And when you are talking about the imposition of criminal sanctions, we are not talking a negligence level of knowledge. You are talking something more than actual knowledge or willful blindness, if you will.

We are not going to be approaching criminal prosecutions in the context of pure negligence. And there are very few strict liabilities—

Mr. SPRATT. So it will be an administrative assessment or penalty that is different from the criminal penalty if you signed it?

Mr. BANKS. One of the big differences in the NAFTA is that when they sign this exporter certificate of origin, they have got to prove their case.

The difference right now many times is that we have to prove the case the other way. With this, they have got to prove their case that this is where they got their products, this is the manufacturer. You place a much heavier responsibility on the importer and the foreign producer to prove it.

And so I don't want to say we are sitting back in a catbird seat more, but at least we are in a situation that we send questionnaires down to them. They have got to demonstrate their case to us before they are going to get trade preference under NAFTA and not to be subject to other penalties. So NAFTA is preferable, far preferable in that sense.

Mr. SPRATT. Thank you, Gene.

Mr. GREEN. There was somebody that had a response to that question concerning the ultimate user or the importer, the retailer, for example?

Again, I believe they are sophisticated. I think they understand the price of a particular merchandise whether it was made in China or made in Hong Kong where the wage per hour is such a disparity. I think we have sophisticated importers in our country.

The question concerning the indictments—and I was just going to ask you for that information—I didn't hear for sure of any importers or retailers that have been indicted or if there are administrative penalties currently on some of the companies that have been doing that?

Mr. RICHARD. It is my understanding that we have indicted importers, but I can verify that and submit formally a statement for the record on that point.

[The information can be found in appendix 2.]

Mr. BANKS. If I could comment on that for a second. The numbers under the Q-TIP, the number of companies that were indicted is five, the number of individuals indicted is nine, at this point.

The number of individuals convicted so far is four. The number of companies convicted is two. And there are 27 more indictments, I believe, pending. So it is not the end of Q-TIP, but it is just an example. It is—it doesn't answer your entire question.

Mr. RICHARD. I am sorry. I thought you were asking specifically how many of those constituted importers.

Mr. GREEN. That is what I would like to look at along with other importers or retailers that were U.S. companies or individuals that were U.S. citizens that were importing, the testimony concerning NAFTA and the new restrictions or the new requirements.

And I know we hear all the time about withdrawing most favored nation status. Has that been discussed with the trade representative or anyone? Normally I know it is a higher level that we talk about that instead of actually reaching that plane on transshipment issues, but—

Ms. HILLMAN. Clearly, the transshipping issue falls both into a tariff and a quota issue.

The most favored nation would affect the tariff status of a country. And obviously the one that remains under consideration is whether or not China will be granted most favored nation status. As you know, last June, the administration decided to give China 1 year more of MFN status. It was made conditional upon improvements, specific improvements in the human rights side.

At the time the administration announced that, they also expressed concerns with a number of other items with respect to China in terms of trade policy. Clearly, the administration will face another decision in June of next year about whether to, again, renew China's most favored nation status. That is something under active consideration. The administration will have to make a decision about whether or not they want to continue to give China most favored nation status. That affects the tariff side of the issue.

On the quota side, in terms of how much textiles and apparel do we permit in from China, that is the function of a bilateral textile agreement that we negotiate with the Chinese that is currently under negotiation.

We have said very clearly to the Chinese that we will not renew a bilateral agreement and we will not allow the current level of textile and apparel imports to come into the country unless we can resolve this issue of transshipment. The problem that we have with the Chinese in terms of overshipments and fraudulent visas and the problem that we have with the Chinese in terms of counterfeiting United States textiles designs and United States apparel trademarks, those three issues must be addressed; otherwise, we will not sign a new bilateral agreement with the Chinese that continues to allow them the level of access and textiles apparel that they currently enjoy.

Mr. GREEN. OK. Thank you.

Thank you, Mr. Chairman.

Mr. SPRATT. Thank you, Mr. Green.

Could we just have for the record, Mr. Richard, a summation of what standard of accuracy is required of an exporter in signing a country of origin certification with goods shipped into this country, textile and apparel goods, or any other goods under existing law. What requirements are there, if any, that apply to importers with respect to certification or representation of the country of origin, and how NAFTA will differ from existing law, both as to exporters and importers.

Mr. RICHARD. I will submit it for the record.

[The information can be found in appendix 2.]

Mr. SPRATT. Let me thank all of you. Customs also.

Mr. BANKS. Yes, sir.

Mr. SPRATT. OK. Good.

Let me thank all four of you for appearing here, testifying, and for your forbearance. This has been a long morning. We feel we have developed some good information for our record, and we very much appreciate your cooperation and your fine testimony. Thank you very much, indeed.

Now, I will call our final panel which consists of four witnesses: Mr. Bremer from the American Textile Manufacturers Institute; Mr. Starobin from the International Ladies' Garment Workers' Union; Mr. Bodner from the National Knitwear & Sportswear Asso-

ciation; and Mr. Sorini from Fruit of the Loom, formerly the chief textile negotiator with the USTR.

I have this order of presentation. If it is agreeable with the panel, Mr. Bremer would go first; Dr. Starobin would go second; Mr. Bodner third; and Mr. Sorini, fourth.

You can be the wrap-up hitter, Mr. Sorini, if that is agreeable.

I will recognize Mr. Bremer. We have your testimony already prefiled as you prepared it, and we will make it part of the record if there is no objection. Mr. Bremer, the floor is yours; so you can proceed by either reading or by summarizing it if you wish.

STATEMENT OF CHARLES V. BREMER, DIRECTOR, INTERNATIONAL TRADE, AMERICAN TEXTILE MANUFACTURERS INSTITUTE [ATMI]

Mr. BREMER. Thank you very much.

I would like to summarize the written statement I submitted on behalf of ATMI.

I appear this morning on behalf of the American Textile Manufacturers Institute, the national association of the textile industry.

In a similar hearing before another House subcommittee in May of last year and in today's hearing, testimony has been presented by U.S. Government and private sector witnesses attesting to the enormous scope of textile transshipments and their impact on domestic producers and their workers.

The transshipment of textile and apparel products in violation of agreements entered into in good faith by the United States is an affront to the United States and is an economic crime, pure and simple.

Furthermore, this crime persists despite the government's best efforts to combat it; and it will continue to persist unless more effective methods to deal with it are developed and stricter penalties for infraction are meted out.

As has been noted on the record, many millions of garments, bed sheets, pillow cases, towels, and millions of yards of fabric have been found to be transshipped and consequently charged back to the quota entitlements of the countries of true origin.

At the same time, however, many millions more garments, furnishings, and yards of fabric have been transshipped and no action taken.

This is because the burden of proof required for the competent authority, the committee for the implementation of textile agreements, or CITA, to take action is so enormous that most offenses go unpublicized and unpunished.

The likelihood or the probability, based on the availability of evidence that transshipment has occurred, is most often not sufficient for CITA to take appropriate action against the offending country. The proof must be complete, incontrovertible, and unassailable.

Given that strict standard, the Customs Service and the Department of Commerce's Office of Textiles and Apparel, nonetheless, have done a remarkable job of exposing transshipments, but more needs to be done.

There can be no question that the efforts of these agencies have served as a deterrent to transshipment, but they have not eliminated the problem, and they will not do so in the future.

To effectively address the problem of transshipment and hopefully eliminate it merely requires the administration to develop the will and then devote the resources necessary to do so.

The Customs Service, which has devoted considerable time and effort to combating transshipments, should devote more personnel to the task. More inspectors, investigators, and auditors are needed. But how can this be accomplished in the current climate of government downsizing and in light of the fact that the Service has been ordered to shed 1,000 employees? The answer is the enactment of the Customs modernization act. Customs personnel who would be freed from their current tasks of manually processing import documents could be, and should be, redirected to enhanced enforcement of the textile import control program. It is for this very reason that ATMI supports the Customs modernization act and hopes to see it become law soon.

A second avenue of approach is for the United States to require better cooperation of foreign governments in investigating transshipments. It should come as no surprise to the subcommittee that some foreign governments have been less than cooperative in this regard.

The U.S. policy should be that any country refusing full and prompt cooperation in the investigation of suspected transshipments should have its exporting privileges for the commodity or commodities being investigated suspended forthwith.

The foreign country in question may, if it wishes, continue to export those goods after such notice has been delivered, but the United States should refuse to admit them into its commerce.

In this event, all such imports should be put into a bonded warehouse and not released until the investigation is completed.

At the same time that such sanctions are invoked, the penalty for transshipment needs to be increased. Current practice, once CITA has made a finding of transshipment, is to deduct from the current year's or following year's quota entitlement requirement of the offending country an amount equal to that which was found to be transshipped.

As ATMI testified last year, this is not really a penalty because it merely makes the charges against the quota that should have been made in the first place. It merely enforces the terms and conditions of the multifiber arrangement and our bilateral textile agreements and, therefore, it has no punitive aspect at all. One could liken it to telling a bank robber to please return to the bank the money he stole and then walk away a free man. This will hardly deter bank robbery.

At last year's hearing, ATMI suggested that the penalty for transshipments should be treble damages, a chargeback against quota of 3 times the amount found to have been transshipped. As has been reported in the press and as you heard this morning, the United States—that is to say the Office of the U.S. Trade Representative—has proposed exactly this penalty for repeat offenders in language to be incorporated in the renewal of our bilateral textile trade agreements and has pressed this point very vigorously. That is the good news.

The bad news is that some of our trading partners, including some of the largest exporters to our market, have flatly rejected this language.

Mr. Chairman, I can only put it this way: If I ask you to sign a document disavowing illegal activity and you refuse to do so, then I must, at the very least, be suspicious of your intentions and your behavior.

To further achieve the aims and objectives of a more rigorous program to deal with transshipments, something needs to be done about the American importers who receive such merchandise.

Except for the prosecutions of Chinatex in New York and Columbia Sportswear in Portland, OR, ATMI is not aware of any other action taken by the Federal Government against importers of transshipped merchandise. Yet, as the record clearly shows, millions upon millions of dollars' worth of goods have been transshipped and received by American importers.

The best way to deal with this is for the Customs Service to issue a notice of redelivery to importers who have been discovered to have received transshipped goods. This action is available now, but current Customs' procedures permit the issuance of a notice of redelivery only within 30 days after the entry is liquidated.

Nearly all transshipment infractions take months to investigate. The timeframe for the issuance of a notice of redelivery for transshipped goods should be extended to not less than 3 years.

It is high time, Mr. Chairman, that the receivers of illegally transshipped goods were held accountable for their participation. I know of no reason in the law why this course of action cannot be pursued.

Further exacerbating the problem of transshipment is the fact that a large quantity of transshipped merchandise which enters our market each year results from the "outward processing" schemes which several foreign countries have employed.

Now, the reasons cited for the employment of these schemes is, "to rationalize production" or, "to lower overall costs" or, "to make the most efficient use of available resources" and so on.

This is dissembling of the highest order. The real reason for the use of outward processing schemes is to avoid U.S. quotas.

Last month, Mr. Chairman, I joined several other industry advisers on a trip to four venues into East Asia for a series of bilateral textile trade negotiations. At a private meeting in one of those venues, a gentleman with intimate knowledge of local practices described to me, in chilling detail, the elaborate trail of phony paperwork created by everyone party to the transaction to obscure the true origin of goods produced and shipped to the United States under "outward processing."

This presentation was sufficient to convince me that our willingness to accept textile apparel imports produced in such fashion needs to be at least examined inside out or, preferably, abolished.

In summary, Mr. Chairman and members of the subcommittee, the transshipment of textile and apparel goods to the United States in order to evade quotas is a violation of international agreements and an illegal activity which costs American workers their jobs or, at the very least, the opportunity to work a full week and maximize their earning potential. It ought to be stopped.

While the various agencies of jurisdiction in the Federal Government have devoted considerable effort to addressing transshipments, efforts for which all segments of the domestic-producing industry are most grateful, more needs to be done.

It is hoped that suggestions offered today will be adopted and made an integral part of our government's textile import control program.

Mr. Chairman, the subcommittee's interest in the matter of transshipment, as manifested in the convening of this hearing, is deeply appreciated by the domestic industry and by the men and women who have been victimized by those who openly and knowingly flout our laws and regulations and abuse our goodwill.

Thank you.

Mr. SPRATT. Thank you very much, Mr. Bremer.

[The prepared statement of Mr. Bremer follows:]

**Statement of The
American Textile Manufacturers Institute**

**To The Subcommittee On Commerce, Consumer
And Monetary Affairs,**

**Committee on Government Operations
U.S. House of Representatives**

In Re:

**The Transshipment of Textile and Apparel
Products To The United States**

October 5, 1993

appropriate action against the offending country. The proof must be complete, incontrovertible and unassailable. Given that strict standard, the Customs Service and the Department of Commerce's Office of Textiles and Apparel have nonetheless done a remarkable job in exposing transshipments. But more needs to be done. There can be no question that the efforts of these agencies have served as a deterrence, but they have not eliminated the problem and will not to do so in the future.

The United States currently restrains exports of textiles and apparel from 45 countries. There are over one hundred other countries, however, whose exports are not restrained. They are free to ship -- and transship -- whatever they wish. Our imports of textiles and apparel involve millions of separate entries through more than one hundred ports each year. Given these dimensions, it is easy to see that the potential for wrongdoing, for transshipments, is enormous. That potential has been and is being realized.

It would seem, therefore, that the problem is intractable and not capable of solution, but this need not be so. To effectively address the problem of transshipment and, hopefully, eliminate it, merely requires the administrative branch to develop the will and then devote the resources necessary to do so.

The Customs Service, which has devoted considerable time and effort to combatting transshipment, should devote more personnel to the task. More inspectors, investigators and auditors are needed. But, how can this be accomplished in the current climate of government downsizing and in light of the fact that the Service has been ordered to shed one thousand employees? The answer is the enactment of the Customs Modernization Act. Customs personnel who would be freed from their current tasks of manually processing import documents could be (and should be) redirected to enhanced enforcement of the textile import control program. It is for this very reason that ATMI supports the Customs Modernization Act and hopes to see it become law soon.

A second avenue of approach is for the United States to require better cooperation of foreign governments in investigating transshipments. It should come as no surprise to the Subcommittee that some foreign governments have been less than cooperative in this regard. The United States' policy should be that any country refusing full and prompt cooperation in the investigation of suspected transshipments should have its exporting privileges for the commodity or commodities being investigated suspended forthwith. The foreign country in question may, if it wishes, continue to export goods after such notice has been delivered, but the United States should refuse to admit them into its commerce. In this event, all such imports should be put into a bonded warehouse and not released until the investigation is completed.

At the same time that such sanctions are invoked, the penalty for transshipment needs to be increased. Current practice, once CITA has made a finding of transshipment, is to deduct from the current year's or the following year's quota entitlement of the offending country an amount equal to that which was found to be transshipped. As ATMI testified last year, this is not really a penalty because it merely makes the charge against the quota that should have been made in

This statement is submitted by the American Textile Manufacturers Institute (ATMI), the national association of the textile industry. ATMI's members collectively account for approximately 75 percent of the raw materials consumed by the textile mill products industry (SIC Industry 22) and are engaged in every facet of textile manufacturing and marketing.

While a separate, distinct (and very important) part of our nation's manufacturing economy, the textile industry is closely allied with its suppliers, chemical fiber producers, wool and cotton growers, and its customers, the apparel manufacturing industry. All three industries, which collectively employ over 2 million people, have been injured and continue to be injured by the transshipment of textile and apparel products into our domestic market where they illegally take business and job opportunities away from our companies and our workers. It is an understatement to say that we feel victimized by such activity and we are angry about it.

In a similar hearing before another House Subcommittee in May of 1992 and in today's hearing, testimony has been presented by U.S. government and private sector witnesses attesting to the enormous scope of textile transshipments and their impact on domestic producers and their workers. The transshipment of textile and apparel products in violation of agreements entered into in good faith by the United States is an affront to the United States and an economic crime, pure and simple. Furthermore, this crime persists despite the government's best efforts to combat it and will continue to persist unless more effective methods for dealing with it are developed and stricter penalties for infraction are meted out.

In considering the phenomenon of transshipment and trying to formulate policies and methods to counter it, ATMI asks the Subcommittee to take into account three facts:

1. The administrative branch of government, in particular the U.S. Customs Service, has done a highly commendable job of detecting and documenting transshipments.
2. Nevertheless, the volume of transshipments that has been publicly disclosed and remedial action taken is but a fraction of the real total.
3. The resources which the administrative branch has brought to bear on this problem have been insufficient to prevent its occurrence and will most likely continue to be insufficient to prevent its recurrence.

As has been noted on the record, many millions of garments, bedsheets, pillowcases, towels and millions of yards of fabric have been found to be transshipped and charged back to the quota entitlements of the countries of true origin. At the same time, however, many millions more garments, furnishings and yards of fabric have been transshipped and no action taken. This is because the burden of proof required for the competent authority -- the Committee for the Implementation of Textile Agreements (CITA) -- to take action is so enormous that most offenses go unpublicized and unpunished. The likelihood or the probability, based on the available evidence, that transshipment has occurred, is most often not sufficient for CITA to take

the first place. It merely enforces the terms and conditions of the Multifiber Arrangement and our bilateral textile agreements and has no punitive aspect at all. One can liken it to telling a bank robber to please return to the bank the money he stole and walk away a free man. That will hardly deter bank robbery.

At last year's hearing ATMI suggested that the penalty for transshipments should be treble damages, a chargeback against quota of three times the amount found to have been transshipped. As has been reported in the press, the United States, that is to say the Office of the United States Trade Representative, has proposed exactly this penalty for repeat offenders in language to be incorporated in the renewal of our bilateral textile trade agreements and has pressed this point very vigorously. That is the good news. The bad news is that some of our trading partners, including some of the largest exporters to our market, have flatly rejected this language. Mr. Chairman and members of the Subcommittee, I can only put it this way: if I ask you to sign a document disavowing illegal activity and you refuse to do so, then I must be, at the very least, suspicious of your intentions and behavior.

To further achieve the aims and objectives of a more rigorous program to deal with transshipments something needs to be done about American importers who receive such merchandise. Except for the prosecutions of Chinatex in New York and Columbia Sportswear in Portland, Oregon, ATMI is not aware of any other action taken by the federal government against importers of transshipped merchandise. Yet, as the record clearly shows, millions upon millions of dollars' worth of goods have been transshipped and received by American importers. The best way to deal with this is for the Customs Service to issue a notice of redelivery to importers who have been discovered to have received transshipped goods. This action is available now but current Customs procedures permit the issuance of a notice of redelivery only within thirty days after the entry is liquidated. Nearly all transshipment infractions take months to investigate. The time frame for the issuance of a notice of redelivery for transshipped goods should be extended to not less than three years. It is high time, Mr. Chairman, that the receivers of illegally transshipped goods were held accountable for their participation. I know of no reason in the law why the course of action suggested here cannot be pursued.

Further exacerbation of the problem of transshipment is the fact that a large quantity of transshipped merchandise which enters our market each year results from the "outward processing" schemes which several foreign countries have employed. The reasons cited for the employment of these schemes in "to rationalize production" or "to lower overall costs" or "to make the most efficient use of available resources", and so on. This is dissembling of the highest order. The real reason for the use of outward processing schemes is to avoid United States quotas. The federal government needs to closely examine this issue and flatly prohibit the importation of textile and apparel goods not wholly produced in accordance with the procedures set forth in Customs Regulation 12.130. If necessary, this regulation needs to be strengthened, rewritten perhaps, in such a way as to unequivocally prohibit the abuses that are presently occurring under these outward processing schemes. Last month, Mr. Chairman, I joined several other advisors on a trip to four venues in East Asia for a series of bilateral textile trade negotiations. At a private meeting in one of those venues a gentleman with intimate

knowledge of local practices described to me in chilling detail the elaborate trail of phony paperwork created by everyone party to the transaction to obscure the true origin of goods produced and shipped to the United States under "outward processing". His presentation was sufficient to convince me that our willingness to accept textile and apparel imports produced in such fashion needs to be at least examined inside out or, preferably, abolished.

In summary, Mr. Chairman, the transshipment of textile and apparel goods to the United States in order to evade quotas is a violation of international agreements and an illegal activity which costs American workers their jobs or, at the very least, the opportunity to work a full week and maximize their earning potential. It ought to be stopped. While the various agencies of jurisdiction of the federal government have devoted considerable effort to addressing transshipments, effort for which all segments of the domestic producing industry are most grateful, more needs to be done. It is hoped that the suggestions offered today will be adopted and made an integral part of our government's textile import control program. The Subcommittee's interest in the matter of transshipments, as manifested in the convening of this hearing is deeply appreciated by the domestic industry and by the men and women who have been victimized by those who openly and knowingly flout our laws and regulations and abuse our good will.

Mr. SPRATT. Mr. Starobin.

**STATEMENT OF HERMAN STAROBIN, RESEARCH DIRECTOR,
INTERNATIONAL LADIES' GARMENT WORKERS' UNION, AFL-
CIO**

Mr. STAROBIN. Mr. Chairman and members of the committee, I would like to comment on two subjects raised in your invitation to testify: Transshipments, and whether Customs has sufficient resources to deal with NAFTA. They are discussed in detail in my submitted statement.

Mr. SPRATT. And may I state for the record, that it will be made part of the record, incorporated in its full form as you submitted it.

Mr. STAROBIN. Thank you, Mr. Chairman. One thing is perfectly clear, and it is that only Customs can testify to the details and the extent of transshipment. We at best can only pick up gossip, hearsay, or analysis.

Eighteen months ago, the then Commissioner of Customs testified before Mr. Dingell's oversight committee that the People's Republic of China was transshipping through more than 30 countries. I now hear it is 40, and twice its bilateral quota.

There was also reference at the time to over 100 possible indictments of companies in the United States involved in transshipments. Despite the commendable efforts of Customs, only one or two indictments have gone forward. If we have the goods on the People's Republic of China, we should be seeing more indictments and more prison terms and more heavy fines. I think the committee should look into why this has not happened, and I see that it is the direction of the thinking of the committee by the questions posed to the prior witnesses.

During a recent trip to the Far East as an advisor to our textile and apparel negotiators, the same trip that Mr. Bremer made reference to, our negotiators were seeking a strong transshipment clause in the bilateral agreements. We learned that each day 20,000 trucks passed through one border point between Hong Kong and the People's Republic of China's free trade zone of Shenzhen. This means one truck every 4 seconds. How can transshipments from this area alone be policed, let alone all the other areas through which Chinese products are shipped?

I would like to commend Ms. Hillman and Ms. Hayes for the vigor with which they are pursuing the transshipment problem. However, in my view, the only way for Customs to deal effectively with transshipments would be for the U.S. Government to control imports through a licensing system rather than leave it to foreign governments and companies. My colleague, Mr. Bodner, will go into this in greater detail, as I read in his testimony when I came into this room. But I would like to mention this as one stronger possibility to control transshipments than the kind of bilateral negotiations that USTR and Commerce are engaged in.

Another alternative also discussed would be a quota auction system. You may recall that the idea of a quota auction system was proposed back in 1989 in the textile apparel bills introduced in this House by Mr. Jenkins and in the Senate by Senator Hollings.

Since the PRC is generally viewed as the principal transshipper, we must also deal with the question of whether the PRC's central government really has control over trade or whether much of it has devolved on the provinces.

I raise this question because those of us who spoke with our Ambassador in China, the deputy chief of mission, and the head of the economic section, received the view that the provinces now have far greater control than one would suspect. And it is of some interest that when this question arose about 5 or 6 years ago in bilateral negotiations with the People's Republic of China, negotiations that were conducted in part by Mr. Sorini, the Chinese Government said that forged visas that were being used were out of their control. They were either being forged by the provinces or in Hong Kong.

Most of us didn't believe that at the time, but it now seems to be reinforced by the statements of our representatives in China, as well as other sources not only in China but in Hong Kong as well. And so this raises the obvious question of whether the People's Republic of China can enforce a transshipment clause, even if it agreed to such a clause.

One further reason why we should pursue the matter of the United States controlling imports through a licensing system is that we are dealing with our market. We are not dealing with any other country's market. We run around the world, if you will excuse the expression, like a bunch of monkeys, negotiating with foreign countries and are giving away our market. And I don't particularly care that the State Department is concerned with reciprocal meetings taking place on both sides. This is our market. We have consistently been giving it away, particularly in the last dozen years.

I would like to turn briefly to a comment on NAFTA. The question is raised, is Customs adequately prepared to ensure that the NAFTA rules of origin are effectively followed and that other countries, particularly those in Asia, preparing to make use of Mexico as an export platform to the United States? I see no evidence to answer that question in the affirmative.

Further, incorrect data, and I think this is a very basic point, Mr. Chairman, incorrect data are used to magnify the virtues of NAFTA.

Customs is part of the problem, because it collects the data which the Bureau of the Census publishes. Our trade data do not distinguish between cut apparel parts sent to Mexico for assembly, and exports of finished apparel. In 1992, Census reported United States apparel exports to Mexico of \$845 million.

Complementary data from the import side show that \$714 million represented returning U.S. components assembled into apparel. In other words, only \$131 million or 15 percent of our reported United States apparel exports to Mexico are really apparel.

We, and when I say we, I mean my organization, the International Ladies' Garment Workers' Union, have tried for 3 years to get the appropriate government agencies to present real data that reflect our real trade with Mexico. This request has fallen on deaf ears. We can only assume that this has been deliberate.

However, the General Accounting Office in another report, which was prepared for Mr. Gephardt and Mr. Sander Levin and released

in July of this year, notes that Mexico excludes from its trade figures imports to be used in assembly work done in maquiladora operations, and presumably free trade zones as well, since the products do not enter the Mexican market. The report fully supports the methodology we have used for 3 years to obtain a more accurate picture of our trade with Mexico. Similarly, detailed analysis of total exports to Mexico in 1992, generally referred to in the NAFTA discussions as consumer exports, show that less than \$8 billion of the alleged \$40.6 billion entered the Mexican consumer market in 1992, a per capita figure of less than \$90, not Carla Hill's \$477, or Mickey Kantor's \$450 plus.

And I should add, Mr. Chairman, that we have made these observations in detail to Mr. Kantor, back about 7 or 8 months ago. And we have not seen any attention being paid to them. The inaccurate figures are constantly repeated. U.S. companies are really trading with themselves. They are not trading with Mexico.

The incorrect data present a distorted picture of Mexico's consumers market, as well as raise serious doubts that increased exports will provide the basis for substantial new jobs in our country.

This committee should see to it that trade data are properly and, if I may use the word, honestly presented so that policymakers and others can have an accurate picture of our foreign trade and its effect on the American people. Thank you.

Mr. SPRATT. Thank you very much, Mr. Starobin.

[The prepared statement of Mr. Starobin follows:]

Before the
Commerce, Consumer and Monetary Affairs Subcommittee,
Committee on Government Operations
U. S. House of Representatives
October 5, 1993

STATEMENT BY DR. HERMAN STAROBIN, RESEARCH DIRECTOR,
INTERNATIONAL LADIES' GARMENT WORKERS' UNION, AFL-CIO

Thank you, Mr. Chairman and members of the Committee, for this opportunity to testify before you. This statement is made in behalf of our 175,000 members who produce women's and children's apparel and related products. Our members live and work in more than two-thirds of our nation's fifty states.

I would like to comment today on two of the subjects raised in your letter of September 15, 1993 inviting me to testify. One relates specifically to the transshipment problem. The other relates to item 5 and raises the question as to whether Customs has sufficient resources to deal with NAFTA's consequences and whether Customs is adequately prepared for the Agreement.

In dealing only with the two issues, I do not want to suggest that the others are not important.

The subject of transshipment invariably raises at least two questions: the extent to which information on transshipments is publicly available and if Customs knows a great deal about transshipments involving China, why have we only witnessed one indictment for illegally transshipped apparel?

It is, of course, difficult for anyone other than Customs to testify on the details of transshipment. At best, our information is essentially based on deduction, rumor and perhaps even well-informed gossip. We know that transshipment presents an enormous additional threat to employment in our industry, already severely impacted by so-called legitimate imports.

About eighteen months ago, Congressman John Dingell held hearings on apparel and textile transshipments. The then Commissioner of Customs, accompanied by members of her staff, testified in detail on illegal shipments emanating from the People's Republic of China.

If my recollection is correct, the Commissioner indicated that Customs had evidence of such PRC transshipments through more than thirty countries. She said that the PRC was shipping twice its quota under its bilateral apparel and textile agreement with the United States.

I do not see how I or others in the industry can add appreciably, and with any degree of accuracy, to Customs' knowledge of the extent of apparel and textile transshipments. There appears to be so much transshipment, especially from China, that the chances are that even Customs has not been able to track its full extent. However, even the most cursory observation

in department and other stores shows that the PRC ships enormous amount of apparel products into our country.

Eighteen months ago the Commissioner spoke of something like one hundred potential indictments of U. S.-based companies for participating in such transshipments. To the best of my knowledge, and despite the highly commendable efforts of Customs, only one indictment has gone forward.

If the evidence was there eighteen months ago, why have we not seen more indictments? I don't have the answer, but it seems to me that this Committee should find the answer to this question.

We know that apparel and textiles are the largest single PRC export and its largest hard currency earner. Articles that have appeared in PRC publications over the years have spoken of the need to further expand Chinese apparel exports. Invariably, such articles have tied the exports to the need to earn the foreign exchange China requires to purchase the technology that would bring its industrial structure into the twentieth century before the twenty first begins.

In late August and early September of this year, I and other industry advisers accompanied the Chief Textile Negotiator at USTR, the Deputy Assistant Secretary of Commerce who heads its Office of Textiles and Apparel and two high level Customs officials on a visit to the Far East. The purpose of this well-publicized trip was to negotiate an additional clause dealing with transshipments to the bilateral agreements with South Korea, the PRC, Hong Kong and Macao.

One of the most startling pieces of information that we learned on that trip was that each day 20,000 trucks, 10,000 each way, pass through one border point between Hong Kong and the PRC's Free Trade Zone in Shenzhen. Based on a 24-hour day, this means one truck every four seconds. Obviously, effective monitoring of such traffic would be impossible. And Shenzhen is not the only border point between Hong Kong and China!

You ask whether the funds the Administration has requested and Congress has provided are adequate to do the job? That's a hard question for even an informed layman to answer. You ask if existing penalties are sufficient to deter transshipment of products to our market and should we publicize infractions?

The obvious answers are, no, the funds are insufficient to deal with the problem. No, existing penalties are not strong enough to deter importers from selling these products in the U. S. market. Yes, infractions should be publicized. More important, if, in fact, we have the goods on transshipments by the PRC, we should be seeing more and more indictments and prison terms and heavy fines, the best deterrents to illegal transshipments.

One form of control that would be more effective than the procedure currently followed would be for the U. S. government, rather than a foreign government, to sell visas against quotas for apparel and textile. Such a program should provide that the paperwork be in place before the product arrives at U. S. ports. This is the only way to control transshipments. At the same

time, it would transfer economic rents from those countries where quota is bought and sold to the U. S. Treasury, rather than to speculators in quotas in Hong Kong and elsewhere. This Committee should consider promoting such a plan; it could give Customs a better handle on transshipments.

Another question raised on our trip to the Far East was whether the PRC central government really has control over trade practices or whether much of it has devolved on the provinces. If the latter is the case, could the central government enforce such a transshipment clause even if it agreed to it?

Five or six years ago, in the course of another bilateral negotiation with the PRC, our government said that the PRC was using phony visas to enhance its shipments of apparel and textile products. The PRC government responded that such visas must emanate from provincial governments or companies or from Hong Kong and that the central government had no control.

We did not believe them and concluded that this was a ruse to cover up PRC government policy. Was what they said true then? Is it true now?

The answer to these questions is very important. If, in fact, the PRC's central government has no or little control over the provinces, how effective would a bilateral agreement on transshipment be? Once again, I do not have the answer. It seems to me, however, our government either has the answer or should be able to get it. That answer may be the most important one in dealing with this problem. If the central government has no control, how effective would an agreement on transshipment be?

I would now like to turn to the question you raise about NAFTA. I suggest that there is reason for considerable doubt about the current nature of our trade with Mexico. Second, presumably in a free trade agreement the borders between our two countries will over time become more and more open. Do we have the facilities to insure that Customs' NAFTA rules will be adequate to the task?

Is Customs adequately prepared to insure that the NAFTA rules of origin are really followed and that other countries, particularly Asian countries, do not make use of Mexico as an export platform to the U. S. I do not have the answer to this question, but I believe that there will be many attempts at circumvention of the rules. This question should be considered very carefully.

The General Accounting Office report on Customs properly points out that Customs "is the initial source of information for international trade statistics on imports used in monitoring and formulating trade policy." (page 13) It is in this context that I would like to deal with U. S. trade data.

We know that incorrect data are being used by NAFTA supporters and the Administration to magnify the virtues of the Agreement. The fact that false data are being used and the need to

do something about it are equally crucial questions that require answers in appraising the role of Customs, let alone the nature of the agreement itself.

The inaccuracies in our trade data have been perpetuated because using correct data would undercut the case for NAFTA.

Permit me to illustrate first how apparel trade, and then overall trade, with Mexico is improperly reported. Although this question is not specifically germane to the present hearings, it must be observed that the way in which trade data are collected and presented creates a totally inaccurate view of our Mexican trade.

Customs is part of this problem if only because it collects trade data which it then reports to the Bureau of the Census, under whose auspices the data are published.

Using reported apparel exports as an example, U. S. trade data do not distinguish between cut apparel parts exported to Mexico for assembly and exports of finished apparel. This creates the illusion of substantial apparel exports to Mexico. Thus, in 1992, the Bureau of the Census reported U. S. apparel exports to Mexico of \$845 million. However, complementary data from the import side show that \$713.6 million represented returning U. s. components now made into finished apparel.

In other words, 85 percent of what are called U. S. apparel exports to Mexico are not really apparel. Our true apparel exports to Mexico are \$131.4 million, not \$845 million.

For the past three years, the ILGWU has urged the Office of Textiles and Apparel of the Department of Commerce and the USTR Textile Office to seek a change in how the data are presented in order to reflect our real trade with Mexico. This request has fallen on deaf ears. After our years of effort and our reasonable request, we can only assume that failure to change the data has been made deliberate.

However, along comes the General Accounting Office in a report to Congressmen Richard Gephardt and Sander Levin dated July 1993 that notes that Mexico excludes from its trade figures imports to be used in assembly work done in maquiladora operations (and presumably free trade zones) since the products do not enter the Mexican market. (U. S.-Mexico Trade (GAO/GDD-93-129)).

The report suggests that a more accurate picture of our trade with Mexico can be attained by taking U. S. component value from import data and subtracting these data from reported exports. That is precisely what we have done and conveyed to the appropriate agencies for the last three years! Yet, incorrect data continue to be used by government witnesses and other NAFTA supporters in congressional testimony, speeches, articles, etc.

On an overall basis, reported U. S. trade with Mexico also overstates the level of our exports to Mexico. The GAO report confirms this.

It should not be surprising, therefore, to find that Mexican trade data for 1992 report imports from the U. S. at a level of half of what U. S. trade data show. As with apparel, overall U. S. trade data include as exports to Mexico parts sent there for assembly in maquiladora factories and free trade zones.

In addition, a substantial part of U. S. capital goods exports to Mexico are used to assemble the U. S. parts before they are returned to the U. S. Capital goods exports to Mexico in 1992 represented one-third of all reported U. S. exports to Mexico.

Put another way, we estimate that 80 percent of U. S. exports to Mexico as reported by the Commerce Department never enter the Mexican consumer market. U. S. companies are largely trading with themselves, not with Mexico.

This question is important because the inaccurate data present a distorted picture of our trade with Mexico and falsify how NAFTA will benefit the U. S. The argument has it that Mexico offers a huge consumer market to the U. S. and that this market will grow and provide the basis for substantial new jobs in the U. S.

Former USTR Carla Hills used such distorted data when she said that on a per capita basis Mexican consumers imported \$477 -- more than Japan -- from the United States. The current USTR Mickey Kantor says that the per capita figure is \$450 plus.

A more accurate analysis of U. S. consumer goods exports to Mexico's consumer markets shows that of the alleged \$40.6 billion in consumer exports to Mexico, less than \$8 billion entered its consumer market, a per capita figure of less than \$90.

Some of my testimony may have seemed to stray from the purpose of this hearing, especially that section dealing NAFTA. However, I do believe that this part of the testimony is involved in dealing with the operations of Customs and may help to put into perspective some of the problems related to NAFTA.

Thank you, once again, for the opportunity to appear before you.

Mr. SPRATT. Mr. Bodner.

**STATEMENT OF SETH M. BODNER, EXECUTIVE DIRECTOR,
NATIONAL KNITWEAR AND SPORTSWEAR ASSOCIATION**

Mr. BODNER. Mr. Chairman, on the assumption that my statement will be included as a part of the record—

Mr. SPRATT. Hearing no objection, that is a correct assumption, we will make it part of the record.

Mr. BODNER. I will summarize my pleasure at being at this hearing by saying that it seems to me, having listened this morning, a really elegant case for an advanced import licensing system has been laid out by practically every single witness who appeared. And I congratulated Mr. Banks for doing that for me.

I think that my view of this situation is essentially as follows. All of the government's actions until very, very recently, and most of what they are now doing, involve an attempt to deal with a huge transshipment problem on an after-the-fact basis. And what we are looking for, quite frankly, is preventive action.

No matter how good the punishment system is, no matter how determined the Customs Service and the Justice Department may be in prosecuting violators, the real economic damage is done when the goods enter the market and displace legitimate domestic merchandise. That is when the harm is done. So if 4 years down the road some guy gets fined, and even if he goes to jail, meanwhile all that stuff comes in and all those people who might have had jobs making legitimate merchandise have lost them. One of the questions posed by this committee, was "What is the impact of this?"

If you take the kind of numbers that are used in the general trade debates of 20,000 workers per \$1 billion of exports, and just turn it around, you are looking at 35,000 to 50,000 jobs annually from transshipped goods that would not otherwise be in the market. The real number is probably higher, because the foreign goods come in at a much lower unit price and it would take more domestic workers to replace that many goods, because of the value differences. So what we are looking for is effective enforcement in a preventive way. And that seems to involve several different things.

We applaud the use of criminal prosecutions insofar as it goes, because we believe it does have a kind of *in terrorem* effect. The average trade person really doesn't want to think about actually himself or herself going to jail over something like that. But the weakness is this incredible time gap between when the cases are initially raised and vetted with the government, or the government discovers them, and when someone is actually sentenced.

I mean the Columbia Sportswear case, which is the one they talk about, was a 4-year operation. And an awful lot happens in 4 years, particularly in the apparel business. So one of the thoughts that we have is that the government will do better and the industry will do better if the enforcement mechanism shifts from looking for the perfect criminal case to an administrative enforcement system that could be much quicker, more certain, and more effective, right up front.

Tied to that is the need to bring the people who are bringing the goods into the country into active responsibility. And I think it is

very clear from the record of this morning's hearing that at the moment there is a big gap between the transshipper in China and somebody who is going to be responsible for it, who is actually buying the goods in the United States.

By the time you get through with layer upon layer of subcontractors, shipper, freight forwarders, and brokers, it is very hard for anybody to determine who is really doing what. There is no reason why, even under the current system, more pressure can't be put on the actual importer in fact—the real buyer of the merchandise—not only to designate a country of origin, but to accept responsibility for knowing, and being able to establish how he knows, what the country of origin is.

People who are buying billions of dollars worth of apparel, and that is what we are talking about, have a pretty good idea of where the factories are. They don't just ship money over blind and say make me some clothes and ship it to me from wherever you feel like it. Mostly, they go into the factories themselves, they have agents in the Far East who go into the factories, they know where their yarn is going, and they know where their fabric is going. If they are buying fabric in one country and shipping it to another country to have it cut and assembled, they know who has got the goods at any given time. And if they don't, they are not in business very long. So we think that those people who are actually bringing the merchandise in, who are going to sell it to the consumer, do know and can be made to say what they know on a form that they file with the government.

Now, I have recommended a system of advanced import licensing to deal in part with the problem of clearing the ports. You cannot talk to a Customs officer at the port level without hearing about this tremendous pressure not to tie up the docks. If we looked at every one of these shipments, we would have this endless log jam. Trucks come in over the Peace Bridge 8,000 a week. We can't deal with that.

If the importer, in fact, had to be licensed to bring those goods into the country, and that license had to be obtained 60 or 90 days before the goods entered the country physically, then there would be a statement of origin made, there would be documentation filed. When 100,000 dozen shirts from a country that nobody ever heard of before are proposed to be licensed, CITA would be able to say this is an interesting document. Why don't we have somebody go and see what this factory is that produced these 100,000 dozen shirts. And they would have 90 days to do that before anybody had anything here on the dock. So there would be a chance to unravel this kind of transshipment system.

There are obviously different sorts of cases. We had a mess in the textile and apparel program and Ambassador Sorini can testify to this mess with the Emirates. All of a sudden we started getting huge volumes of knit shirts out of countries that were not in that business before. There was a lot of after-the-fact investigation. There was a lot of adjustment of quotas. But again, an awful lot of merchandise was in the country before anybody knew what happened, before anybody had a license.

If the United States licensed apparel in advance, even from countries where we have no agreements, so that before the goods arrive,

a new starter has to show that it has something or we have an embassy there that can send somebody out under instructions and look, we would be way ahead of the game. If we were able to do all of the large apparel countries, we would be in even better shape. It is conceivable to me that a test program could be done on a system like this with some countries, not necessarily everybody at the same time. But there is no substitute for putting more of the burden at the U.S. port.

The United States for 25 years has gone around in the textile arena and negotiated its way to various kinds of solutions. And many, many times, we were told in the good old days, why is it you people are asking us to solve your problem, why don't you just do it? And we always had a lot of elaborate reasons why we wanted them to be involved in the process, but the question is fundamentally a good one. If you are so concerned about this problem, why don't you do something about it? Why do we believe that the Hong Kong Government is seriously interested in enforcing our origin rules?

It is very hard to imagine that. They talk a great game, they show our Customs people a wonderful paper trail. It is fabulous. It is on paper. I mean everything under the sun is on paper about transshipment and outward processing, and there is a whole separate issue as to how those rules evolved to where they are, which we will pass this morning, but the assumption is that what is on paper is fact. And Mr. Starobin is correct, we were told about incredible volumes of truck traffic and incredibly little time to decide which trucks to look at, even to look at, and then we were told that when they look at those trucks, this doesn't mean they unpack the boxes. It means they open the back of the truck, maybe, 4 percent of them. So what are we talking about?

We are talking about a situation where our government is being told by Hong Kong, "Well, our people are no more liars than your people, and we are shipping all this stuff, and we have this great document system. Show us that it is wrong." We don't have any basis for showing them that it is wrong. The people who are buying the goods know where the goods are coming from. The government tells us they are putting heavy pressure on China. The Chinese seem to be terribly receptive to United States pressures, witness the atomic bomb they blew up this morning. I don't know what leverage the textile negotiator has that the President doesn't have, but it better be very, very good or this system isn't going to work.

I think with that, I will quit, and turn the floor over to Ambassador Sorini. Thank you, Mr. Chairman.

Mr. SPRATT. Thank you very much, Mr. Bodner.

[The prepared statement of Mr. Bodner follows:]

Statement of Seth M. Bodner, Executive Director
National Knitwear and Sportswear Association
before the
Committee on Government Operations, Subcommittee on
Commerce, Consumer, and Monetary Affairs
Washington D.C. October 5, 1993

SUMMARY: Textile and apparel transshipments continue to vex administrators, deny industry and labor the intended benefits of the international textile agreements program, frustrate the purposes of the MFA, and undercut the position of legitimate traders. They have the potential to create intense international problems. Unless resolved, the transshipment problem will wreck the MFA and sink the textile import control program, taking thousands of jobs with it.

The GAO report (GAO/AIMD-93-3) identified numerous problems in Customs Service's handling of its responsibilities in the field of trade monitoring and control. The deficiencies reported by the Comptroller General in this report go to the very core of Customs' responsibilities and, to some extent, confirm our basic long standing concerns that the sheer growth in volume of trade, coupled with the massive burdens involved in the narcotics trafficking issue have combined to simply overwhelmed the Agency's ability to deal with basic trade functions. Major effort will be required to bring these identified problems under a degree of effective control, even as new burdens from the pending NAFTA and GATT agreements appear on the horizon.

On textile transshipments, a workable start toward a solution of the transshipment problem, one which can be done under present law and executive order without imposing major resource burdens on the enforcement agencies, would be the imposition of an advance import licensing system. This would require that all textile and apparel products proposed to be imported would be required to have their importation licenses prior to importation. Licenses would be issued by the U.S. to U.S. persons or firms located within the U.S. and would provide a vehicle through which origin and quota availability determinations could be made prior to importation of the merchandise in question. Unlicensed goods would be denied entry.

STATEMENT:

Mr. Chairman and members of the Committee. I am Seth M. Bodner, Executive Director of the National Knitwear and Sportswear Association. While our Association is made up of several hundred domestic manufacturers of knit apparel and fabrics of various types, and of companies providing certain affiliated services such as design, sample making and the like, I would like to speak today essentially on a personal basis insofar as my specific licensing recommendations are concerned. Time has not permitted us to undertake a further review of the issues raised by these timely hearings, I believe my experience in this arena both in the government and as an industry advisor and member of numerous official advisory committees warrants putting forward some thoughts on this subject that may be worthy of further examination by the agencies involved as well as by this Subcommittee.

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To summarize my experience for this record, I served in the Department of Commerce in various capacities from late 1964 through 1974, during which time I worked extensively as an attorney advisor on the textile program and later directly in negotiations on countless bilateral and multilateral textile agreements. These included several extensions of the Long Term Cotton Textile Arrangements, the first bilateral agreements on wool and synthetic textiles negotiated in the Far East in 1971 and subsequently the first Multi-Fiber Arrangement covering cotton, wool and synthetic fiber textiles which was completed at the end of 1973. I was appointed Deputy Assistant Secretary for Resources and Trade Assistance in March of 1973 and chaired the Committee for the Implementation of Textile Agreements. My work at the Department was recognized with the Department's Gold Medal and my selection in 1971 for the Arthur S. Flemming Award as one of the ten outstanding young men and women in the federal service. Presently, I serve on the textile ISAC (#15) and the Treasury Department's Advisory Committee for the Commercial Operations of the Customs Service.

THE GAO REPORT OF JUNE 30, 1993 (GAO/AIMD-93-3 CUSTOMS 1992 FINANCIAL STATEMENTS)

From our perspective, two extremely disturbing items in this report were the Comptroller General's comments on two issues of concern to us. At page 13 of his report, he notes that,

"We found no significant internal controls to ensure that merchandise entering the United States was identified and the proper duty assessed. Due to vast quantities of import activity and a poor internal control environment, we could not reasonably test whether dutiable merchandise that entered the United States was identified and the proper duty assessed."

Earlier, the report noted that ,

"We also found that detailed record of who owed Customs were not routinely reconciled nor updated in a timely manner. In addition, the records included debtors that did not owe Customs and excluded some that did. The problems were particularly evident in receivables resulting from fines and penalties and supplementary duty assessments. Consequently, Customs did not have an accurate record of who owed it money, or how much, for two of its largest accounts receivable categories."

In essence, the Comptroller General found Customs weakness in identifying what has come into the country and how it should be treated, and, on top of that, even where penalties are due, an inability to maintain a proper collection system so that those who have violated the laws are assessed the appropriate amounts.

To some extent, the problems described mirror comments in the trade regarding the relatively slim chances of violators being caught. There is a widespread perception that evasion of U.S. Customs regulations is common. Nowhere is this more true than in the field of textiles. While various control procedures exist that look good on paper, the shortfall between the paper promise and the actual working of the system seems considerable. The Comptroller General's report does nothing to alter that perception. Customs is doubtless making major efforts to establish better controls in these situations, and Customs management seems open to suggestions and new ideas,

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but these are not new problems and the burdens of increased trade flow seem to multiply as fast as Customs can introduce new systems, perhaps faster.

One issue of concern to the commercial community generally, is the heavy involvement of Customs in anti-narcotics work. As the GAO report financial statement shows, (p. 74) Customs operates a significant air force--to the tune of \$350,000,000 in asset value. This costs in terms of the Customs operating budget, and more to the point, clearly takes up a major portion of the Service's time and attention. Drug interdiction may be important, but is this the best agency to handle the problem, and more to the point, what is being sacrificed in commercial enforcement field to maintain this operation? The Treasury Department's Advisory Committee for the Commercial Operations of the Customs Service has addressed these issues in a letter to Secretary Bentsen. The Secretary met with the Committee and has assured us of his willingness and interest in looking into the various points raised in the letter. Fundamentally, our concerns are about the ability of the Service to meet the heavy challenges of expanding trade and enforcing trade laws while serving simultaneously as the key border control agency for other purposes as well, most especially in the narcotics interdiction arena. In short, we doubt whether the allocation of Federal resources to Customs has matched its assignment of responsibilities.

IMPACT OF TRANSSHIPMENTS

Over the years, the problem of transshipments ebbed and flowed with the tides of the market, yet each receding tide seems to leave behind a larger line of trashed agreements, frustrated negotiators and even frayed tempers. Strong domestic market conditions gave incentive to import from the lowest cost producers whether or not quota was available. If quota filled, other ways would be found to get goods into this market. Typically, however, if the domestic market weakened, the tendency to transship was sharply reduced --there was ample quota available to fill the weakened demand and the perceived risks of capture by enforcement authorities discouraged the venture in a weak market. But this appears to have changed, doubtless for a variety of reasons.

Now, despite weak domestic markets and even the presence of unfilled quota in some countries, the tides of transshipment appear to be running at full-moon strength. Many point the finger at China as the prime source for such merchandise. Customs has estimated a vast trade (more than \$2,000,000,000) in illegitimate goods, and numerous efforts are presently underway to resolve outstanding transshipment charges. Some estimates have been much higher. There are criminal investigations and bilateral negotiations. And there is continuing investigative activity at the operating levels short of active criminal investigation. But the problems persist.

Perhaps the major reason why China has emerged in this unfortunate role lies in the spectacular changes that have occurred there in the past few years. By all accounts, our most recent visit to China and Hong Kong suggest that these changes have meant a dramatic lessening of the actual control exercised by central government authorities in Beijing over their countrymen in the provinces, especially those in the heavy manufacturing and exporting zones associated with textiles and apparel. In short, without questioning motivation, even if one assumes that China's central government authorities are genuinely interested in maintaining control consistent with the obligations of the bilateral agreements they have entered into with the United States, there is much doubt of their practical ability to do so.

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China does not stand alone as a source of transshipped goods. Pakistan and others have been identified, and the flow-through states are a veritable geographer's paradise. Now, Viet Nam looms as a major problem in this area. The trade already is rife with reports of goods moving from Viet Nam through Taiwan into the U.S. market, sometimes, it is reported, with the active encouragement of Vietnamese officials. Most recently, in the July import figures, major increases are shown from the Dominican Republic. Indeed, it is described by Commerce Department officials as being one of the larger growth areas for U.S. imports. Is all of that local production? There have been some Customs visits to that country--what have they found? What about the so-called "free trade zones" in Panama and elsewhere in the Caribbean? Who visits these zones? Who checks on real production? Who monitors trade flows into and out of these special areas?

Mr. Chairman, in May of last year, then Treasury Assistant Secretary for Enforcement Peter Nunez made an interesting and rather candid speech to the Customs Lawyers Association. He spoke of enforcement problems, and he referred to comments indicating that "...the bad element within the trade community is no longer afraid of Customs, that they believe that Customs' examinations and audits are so infrequent and so cursory that there is little chance that they will be caught." Mr. Nunez also spoke of Operation Q-Tip, which he reported, executed 139 federal search warrants and 46 seizure warrants nationwide. Millions of documents and millions in property were seized. he also reported on the work of various textile "jump teams", noting that, "...not surprisingly, these jump teams have regularly confirmed suspicions that goods from other country subject to U.S. textiles quotas are being merely transshipped through the exporting country. Out of 694 factories inspected worldwide for product verification, 553 were found to be transshipping goods produced elsewhere...." (Nunez p.11) How much has changed since that frank assessment?

Aside from a very few, and mostly Chinese companies--save Columbia Sportswear-- what has operation Q-Tip yielded? Of the millions of units of goods imported, and the billions of dollars which Customs itself estimates as being transshipped, how many important buying organizations have been identified, much less prosecuted or confronted administratively? If there are billions of dollars of illegal goods, why haven't more been identified? \$4,500.00 in apparel seized surely is a minute percentage of the volume of illegal goods estimated.

Trade of this magnitude is not conducted by small shop owners, but by giant movers of goods. Enforcement will be more effective when the major movers of these transshipped goods are caught up along with the domestic representatives of Chinatex. Customs' credibility is not aided by the large gap between the rhetoric of goods being transshipped--rhetoric which we feel is likely to be an understatement--and the reality of the companies identified, fines paid, or even jail terms meted out. This is especially true when we realize that getting resolution of the Columbia Sportswear case took five years of investigation.

Secretary Nunez spoke of the need for strong commitment to enforcement, and the apparent need for added resources to cover the burdens of NAFTA and expanding trade with the inevitable conflicts between enforcement and facilitation. He referred specifically to the growing concerns

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in the Congress and elsewhere that pressure for trade facilitation was causing a reduction in vigilance, and promised to work for a "golden mean" between enforcement and facilitation. But Mr. Nunez is out of office now, and we remain confronted with the problems he addressed. For our part, the answer is unlikely to be found in adjustment of penalties or even in the greater use of criminal statutes. We cannot afford to wait five years for a one- case- at- a- time approach to the problem, five years during which the imports continue uninterrupted from uninvestigated transshippers and perhaps even from the very targets of the investigation. We suffer the consequences of the non-resolution of this problem. Our companies and workers lose out when the fundamental rules of the quota program are flagrantly frustrated by a trade that functions without limit. We have watched companies close and industry employment decline while imports from countries whose cost structures appear on the face of things to put them out of certain markets continue to flow into the U.S. at prices that defy the experience of domestic experts. If we take the common figure for used in connection with asserting the employment benefits of U.S. exports -- 20,000 jobs per \$1 billion -- and apply it to job displacement for imports, then the \$2 billion in transshipped imports must be displacing 40,000 jobs. (The real figure doubtless is higher as the unit value of imports typically is well below the unit value of domestic production, and it is the units and their associated labor that are being lost.)

We are not the only losers. During the last important review of the MFA in Geneva in 1986, the protocols of extension were modified to include stronger language on the transshipments question. Again in the pending GATT agreement transition package on textiles, improved language on transshipments was negotiated. These developments evidence the growing international concern about the subject. Many countries and honest traders recognize that the transshipper cheats them too. This perception extends to European, Asian and Caribbean industries and governments as well as to our own. All countries and all legitimate producers are coming to understand that so long as a system of agreements and quotas is in place, its enforcement must be equitable and effective for all if it is to avoid the unhappy result of helping the cheaters and disadvantaging only those who abide by its rules.

What we need is PREVENTIVE ACTION and a rapid imposition of justice where violations are found. We need :

- an early clearance system so that the decisions on origin and entry are not tied in to the continuing pressure to "clear the ports.; and
- an increase in physical inspections of both goods in transit and premises of manufacture where there is reason to doubt origin or classification.

Now, and for some years, physical inspection has been a small sample, limited by Customs' lack of resources and an overriding fear of tying up the ports instead of clearing them. Real improvement will come only with the availability of real resources, and a greater recognition of law enforcement as a fundamental Customs responsibility, perhaps even ahead of "clearing the ports." And there is no real system of advance clearance and review of entries for purposes of determining origin issues. Visas and licenses are issued, but these do not involve a U.S. check on origin, and in non-quota country situations, they do not exist at all.

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In the last analysis, it is not industry's role or responsibility to investigate and make these cases. This is a governmental function. And industry surely cannot resolve these cases. Criminal cases appear to take an extraordinary amount of time and likely of personnel and other resources as well. Perhaps it is time to recognize that effective enforcement and real improvement will come only if the system shifts its focus to a search for quick and potent administrative remedies from its current preoccupation with the search for perfect criminal cases. Present government practice calls for monitoring of the trade, for investigation of apparent cases of transshipments --whether raised by industry or by government investigators-- and for bilateral and multilateral consultations and discussions. Where possible, criminal proceedings have been brought, but the record is relatively clear on one issue at least, firm results are few and far between. And all of this is after the fact when damage has been long done.

WHAT TO DO? ADVANCE IMPORT LICENSING SYSTEM

The time has come to establish a system of advance import licensing of textile and apparel imports.

All merchandise subject to the MFA should be subject to the requirement of obtaining a license for importation in advance of presentation at the port of entry for admission into the commerce of the United States.

Such an Advance Import Licensing System (AILS) would provide ample opportunity for Customs and the administering agencies to make accurate determinations of origin and quota accountability -- where that is relevant-- and would largely if not totally prevent situations now too common in which the fraud is committed, the market damage done, and consultations are held later, sometimes months and even years after the fact.

The licenses should be granted only to importers in fact, those prepared to take full responsibility for the origin of the goods being imported, those who can-- and will be required to-- provide full information thereon, and those who will not be able to hide behind veneers of subcontractors, freight forwarders or brokers. While paperwork and Customs processing could be handled by brokers and others acting in their behalf, in the usual manner, the actual license applications and the licenses granted would be signed by, and granted to, only those taking full responsibility as importers in fact. No consignees, no unlisted owners, etc. By dealing with domestic importers in fact, it should be possible to work with those who know-- or can be compelled to know-- the true origin of the goods and can readily prove it if asked. With adequate publicity for such a system --which would doubtless occur-- the real burden would be negligible. Except on those attempting to end-run the system.

AILS should cover goods subject to existing quotas and goods that could be subject to quotas if appropriate findings were made under the MFA criteria. It definitely should not be a control program in disguise. It need not be. It would, after all, operate within a control program that is open, negotiated, and publicly justified under established and internationally agreed rules. Thus, licenses would be granted automatically in any quantities requested where there were no quotas on imports from a given country --i.e. where trade from that country was not controlled under a bilateral, or where a particular category was not subject to limit, provided only that the goods definitely are of the national origin claimed, and that the quantities requested are real --i.e.

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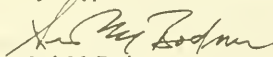
for actual business demands, and are not fictional for the purpose of possible later importation. Foreign governments could be encouraged to provide back-to-back licenses, easing the identification issues and protecting legitimate trade from unnecessary and unproductive questioning. But the fundamental responsibility must fall on the U.S. side of the transaction, and the implementation responsibility on U.S. authorities.

Mr. Chairman and members of the Subcommittee, this is neither the time or place to elaborate the details of an AILS. But the current system is broken. An AILS would help to ensure that the benefits intended from the quota program --whether the present MFA program, the GATT transition agreement program, or some other similar program with similar objectives, actually go to the intended beneficiaries. It would reduce damage done by goods from a country whose quotas are filled but continues shipping through third countries. It would prevent a massive low-wage producer like China from serving as a proxy for higher cost countries that circumstances have rendered non-competitive. Whether intended beneficiaries be the domestic producers or those in foreign countries whose governments have negotiated for quota positions-- or even, I regret to say --those in foreign countries such as Turkey or the Philippines who received quota positions as "foreign policy" rewards, an AILS would at least help the U.S. accomplish its objectives.

Finally, Mr. Chairman, I believe that ample domestic and international authority for an AILS along the lines I have suggested exists. [See particularly Executive Order 12475 of May 9, 1984 issued under Section 204 of the Agriculture Act of 1956 as amended and the Arrangement Regarding International Trade in Textiles and protocols of extension, especially Paragraphs 16 & 17 of the July 31, 1986 extension. See also Article 5 of the Textile Transition Agreement contained in the Uruguay Round draft.]

I urge the Committee to request the Customs Service and the CITA to move now to jointly examine an Advance Import Licensing System, including the development of regulations to bring it into effect at the earliest possible date.

Thank you for giving me this opportunity to appear before the Committee.



Seth M. Bodner

NKSA

386 Park Ave. South
New York City, N.Y.
10016

Mr. SPRATT. Mr. Sorini, and as with the earlier witnesses, your prepared testimony will be made, without objection, part of the record.

**STATEMENT OF RONALD J. SORINI, SENIOR VICE PRESIDENT,
INTERNATIONAL DEVELOPMENT AND GOVERNMENT RELATIONS,
FRUIT OF THE LOOM, INC.**

Mr. SORINI. Thank you. With your permission, then, I will be very brief. As you know, I represent Fruit of the Loom. We face transshipments in the marketplace every day. We clearly have lost sales because of the transshipments. In fact, recently we were forced to lower prices on products in certain segments of the market because of the price pressures we are facing from transshipments. So we thank you for holding these hearings, and we think that it is time to take very, very strong action to deal with transshipments.

Everyone has really talked about a three-pronged approach to dealing with transshipments. One is to go to the source, which is primarily China. I agree with what Mr. Green said earlier, you can penalize China all day long, but as long as they have places to transship through, it is not going to stop the problem. In fact, we have a trade embargo with Vietnam, but yet Vietnam is transshipping products to the United States market. So it doesn't matter if you do a 10-times penalty with China if we do not address the other two aspects of the problem. So I think emphasis really has to be given to the other two parts of the problem.

One is the transshipment point. I don't see why countries need to have unrealistically high quotas if they don't have the productive capacity. And I think if we lower the quotas to actual productive capacity levels, it would take a tremendous burden off of Customs' shoulders. People tease me when I start talking about this problem, asking why didn't you do more when you were the chief textile negotiator. Perhaps now I wish we did, but I do think that we got a good start on the problem. We did reduce Taiwan's quotas because of transshipments. We did reduce Macao's quotas because of transshipments. So it is possible to do that. But fundamentally, I come to the conclusion, as Mr. Bodner did and others do, that to stop the problem or to get a handle on the problem, you do need to require the importers to take greater responsibility.

No country in the world is going to force their citizens to follow the laws and enforce our trade agreements if we are not willing to do that. We did start that process, I think, with requiring the manufacturer's ID on the visa system. That was a small step forward toward requiring the importer to put more information on the import documentation. Whether you call it licensing or whether you come up with a new import declaration, I think it is very clear you need to have the importer identify the factories where goods they are claiming were made in a particular country. They need to give the names of those factories, and they need to take responsibility for the country of origin they are declaring on their import declaration.

In conclusion, let me just say that I think that the NAFTA does include, if it is enacted into law, some very good provisions for dealing with transshipments. We would hope that those provisions

would be extended to other free trade agreements. I noted in my testimony that Israel, for example, recently negotiated a free trade agreement with China. We think that does open the loophole for transshipments through Israel. We think that as a result of the changed circumstances that the NAFTA rules of origin should also be applied with Israel and that the enforcement mechanisms included in NAFTA should be applied to Israel, and perhaps incorporated in our bilateral textile agreements. With that, thank you, Mr. Chairman.

Mr. SPRATT. Thank you very much, Mr. Sorini.

[The prepared statement of Mr. Sorini follows:]

**STATEMENT OF RONALD J. SORINI
FRUIT OF THE LOOM, INC.**

**BEFORE THE SUBCOMMITTEE ON COMMERCE, CONSUMER &
MONETARY AFFAIRS**

U.S. HOUSE OF REPRESENTATIVES

OCTOBER 5, 1993

MR. CHAIRMAN, I AM GRATEFUL TO HAVE THE OPPORTUNITY TO OFFER MY COMPANY'S VIEWS ON TEXTILE TRANSSHIPMENTS TO THE SUBCOMMITTEE. MY NAME IS RON SORINI, I AM SENIOR VICE PRESIDENT, INTERNATIONAL DEVELOPMENT AND GOVERNMENT RELATIONS, FOR FRUIT OF THE LOOM, INC. -- A \$2 BILLION INDUSTRY LEADER. PRIOR TO JOINING FRUIT OF THE LOOM, I WAS THE CHIEF TEXTILE NEGOTIATOR AT THE OFFICE OF THE U.S. TRADE REPRESENTATIVE. THUS, I OFFER MY VIEWS FROM THE PERSPECTIVE OF BOTH A FORMER GOVERNMENT NEGOTIATOR AND AN INDUSTRY REPRESENTATIVE.

FRUIT OF THE LOOM IS A VERTICALLY INTEGRATED MANUFACTURER OF ACTIVEWEAR, CASUALWEAR, INFANTSWEAR, UNDERWEAR AND FAMILY SOCKS. OUR EMPLOYMENT IN THE UNITED STATES HAS INCREASED FROM 18,000 IN 1987 TO 30,000 AS OF JULY OF THIS YEAR. WE SPIN NINE MILLION POUNDS OF YARN PER WEEK. WE CONSUME ABOUT ONE MILLION BALES OF COTTON EACH YEAR, USING ROUGHLY 15 PERCENT OF THE U.S. COTTON CROP. WE CONTINUE TO INVEST HEAVILY IN NEW PLANT AND EQUIPMENT TO REMAIN A WORLD-CLASS U.S. TEXTILE AND

APPAREL MANUFACTURER: THIS YEAR ALONE OUR TOTAL CAPITAL EXPENDITURES WILL BE APPROXIMATELY \$250 MILLION.

MR. CHAIRMAN, WE BELIEVE YOUR CALLING THIS HEARING IS MOST APPROPRIATE. TRANSSHIPMENTS HAVE NOW REACHED THE POINT WHERE MUCH STRONGER ACTION IS REQUIRED. BESIDES THE ECONOMIC IMPACT OF TRANSSHIPMENTS, IT IS UNDERMINING THE CREDIBILITY AND POSITION OF OUR COUNTRY. IF THE UNITED STATES DOES NOT DEVELOP STRONGER STEPS TO DEAL WITH THIS PROBLEM, IT WILL CONTINUE TO UNDERMINE THE CREDIBILITY OF U.S. TRADE AGREEMENTS.

DESPITE THE COMMENDABLE EFFORTS OF U.S. CUSTOMS SERVICE AND OTHER GOVERNMENT OFFICIALS, APPAREL TRANSSHIPMENTS CONTINUE TO ENTER THE U.S. MARKET IN LARGE QUANTITIES AND AT EXTREMELY LOW PRICES. AT TIMES WE ARE ABLE TO OBTAIN SPECIFICS ABOUT TRANSSHIPMENTS SCHEMES. INDEED, WE RECENTLY FORWARDED INFORMATION AND SAMPLES TO THE U.S. CUSTOMS SERVICE AND THE FEDERAL TRADE COMMISSION FOR THEIR INVESTIGATION.

TRANSSHIPMENTS ARE PLACING SEVERE PRICE PRESSURE ON U.S. MANUFACTURERS IN CERTAIN SEGMENTS OF THE MARKET. THIS IS A SIGNIFICANT PROBLEM TO A LARGE COMPANY LIKE FRUIT OF THE LOOM, BUT IT CAN BE DEVASTATING TO THE HUNDREDS OF SMALL TEXTILE AND APPAREL MANUFACTURERS THROUGHOUT OUR COUNTRY.

U.S. COMPANIES MUST COMPETE WITH BILLIONS OF DOLLARS OF IMPORTS EACH YEAR THAT SHOULD NOT BE ENTERING THE COUNTRY. TO ADD INSULT TO INJURY, THE PRIMARY SOURCES OF TRANSSHIPMENTS ARE GENERALLY CHINA, INDIA AND PAKISTAN: COUNTRIES THAT CLAIM TO HAVE A COMPARATIVE ADVANTAGE IN TEXTILES AND APPAREL, BUT DO NOT GIVE US THE OPPORTUNITY TO COMPETE IN THEIR MARKETS.

IN MY JUDGEMENT, THE U.S. CUSTOMS SERVICE IS DOING AN ADMIRABLE JOB GIVEN THE RESOURCES THEY HAVE TO COMBAT THE PROBLEM. CUSTOMS NEEDS ADDITIONAL MANPOWER TO CONDUCT INVESTIGATIONS, INCLUDING ON-SITE VISITS TO PLANTS IN EXPORTING COUNTRIES, TO DEAL WITH THE MASSIVE VOLUMES OF ILLEGAL TRANSSHIPMENTS ENTERING OUR MARKET. IN

ADDITION, THE PROBLEM CAN BE ADDRESSED ON THREE OTHER FRONTS, WHICH WOULD PARTIALLY EASE THE BURDEN ON U.S. CUSTOMS.

FIRST, EXPORTING COUNTRIES MUST TAKE GREATER RESPONSIBILITY FOR TRANSSHIPMENTS. WHILE MANY COUNTRIES COOPERATE WITH U.S. CUSTOMS, SOME DO NOT TAKE SUFFICIENT ACTION TO DETER TRANSSHIPMENTS. AS A GOVERNMENT NEGOTIATOR, IT WAS INFURIATING WHEN A FOREIGN GOVERNMENT OFFICIAL WOULD SAY "TRANSSHIPMENTS ARE NOT OUR PROBLEM, U.S. CUSTOMS MUST DO A BETTER JOB AT THE PORTS." THESE SAME COUNTRIES INSIST THAT QUOTA ALLOCATIONS MUST BE IN THE HANDS OF EXPORTING COUNTRIES SO THEY CAN CAPTURE THE QUOTA RENTS.

QUOTAS FOR COUNTRIES THROUGH WHICH GOODS ARE TRANSSHIPPED MUST BE BROUGHT IN LINE WITH REALISTIC PRODUCTION CAPACITY. IF QUOTAS ARE NOT IN PLACE WITH HIGH RISK TRANSSHIPMENT POINTS, THEY SHOULD BE ESTABLISHED. THE NEW POLICY TO ADD PROVISIONS TO BILATERAL TEXTILE AGREEMENTS ALLOWING FOR TRIPLE CHARGING IS A GOOD FIRST

STEP. HOWEVER, TRIPLE CHARGING ONLY WILL WORK WHEN SPECIFIC TRANSSHIPMENT SCHEMES ARE IDENTIFIED. CUSTOMS STILL WILL BE REQUIRED TO DEDICATE AN INORDINATE AMOUNT OF RESOURCES TO PROPERLY SCRUTINIZE SHIPMENTS FROM HIGH RISK TRANSSHIPMENTS POINTS. IN 1991 BOTH TAIWAN AND MACAU AGREED TO QUOTA REDUCTIONS TO REDUCE THE RISK OF TRANSSHIPMENTS. SETTING QUOTAS AT PRODUCTIVE CAPACITY LEVELS WITH ALL HIGH RISK TRANSSHIPMENT POINTS WOULD EASE THE BURDEN SUBSTANTIALLY ON CUSTOMS.

SECOND, COMPENSATION MUST BE OBTAINED FROM THOSE COUNTRIES WHERE TRANSSHIPMENTS ORIGINATE. FOR COUNTRIES SUCH AS CHINA, QUOTA REDUCTIONS MUST BE NEGOTIATED TO COMPENSATE FOR THE DAMAGE DOMESTIC PRODUCERS HAVE INCURRED BECAUSE OF TRANSSHIPMENTS. HOWEVER, VIETNAM, WHICH IN THE PAST AT LEAST HAS BEEN A SOURCE OF TRANSSHIPMENTS, POSES A UNIQUE PROBLEM. IF THE TRADE EMBARGO IS LIFTED, QUOTAS SHOULD BE NEGOTIATED QUICKLY TO ELIMINATE THE RISK OF DAMAGE TO DOMESTIC PRODUCERS AND TO OBTAIN COMPENSATION FOR PAST TRANSSHIPMENTS.

LASTLY, UNSCRUPULOUS IMPORTERS MUST BE PROSECUTED QUICKLY. THEY MUST KNOW THE RISK OF TRANSSHIPPING IS HIGH AND THE PENALTIES SEVERE. IMPORTERS MUST TAKE RESPONSIBILITY FOR THE COUNTRY OF ORIGIN CLAIMED ON IMPORT DOCUMENTATION. IMPORTERS SHOULD BE REQUIRED TO IDENTIFY THE SPECIFIC FACTORIES WHERE FABRIC IS CUT AND SEWN ON THE IMPORT DECLARATION FORM. IF THE CUTTING AND SEWING TAKES PLACE IN DIFFERENT FACTORIES, BOTH SHOULD BE LISTED. THIS WILL GIVE CUSTOMS EASY ACCESS TO INFORMATION SO THAT THEY, WORKING WITH FOREIGN GOVERNMENT OFFICIALS, CAN MORE EASILY VERIFY PRODUCTION CAPACITY WHEN NECESSARY. IT ALSO WOULD ELIMINATE THE EXCUSE THAT AN IMPORTER DID NOT KNOW WHERE THE GOODS WERE MANUFACTURED BECAUSE HE PLACED THE ORDER WITH SOME MIDDLEMAN THAT SUB-CONTRACTED THE PRODUCTION FROM "SOMEONE" DOWN THE STREET.

ELIMINATING ILLEGAL TRANSSHIPMENTS WOULD BE OF TREMENDOUS BENEFIT TO DOMESTIC TEXTILE AND APPAREL MANUFACTURERS AND THEIR TWO MILLION EMPLOYEES. THIS, ALONG WITH ENACTMENT OF THE NORTH AMERICAN FREE TRADE

AGREEMENT (NAFTA) WOULD, AS ONE PROMINENT INDUSTRY EXECUTIVE HAS SAID, LEAD TO THE "RENAISSANCE OF THE TEXTILE INDUSTRY." I KNOW SOME PEOPLE QUESTION THE ABILITY OF U.S. AND MEXICAN OFFICIALS TO CONTROL TRANSSHIPMENTS UNDER A FREE TRADE AGREEMENT. CLEARLY, FREE TRADE AGREEMENTS, LIKE UNREALISTICALLY HIGH QUOTAS, CAN BE INVITING FOR TRANSSHIPPERS. BUT WITH PROPER COOPERATION BETWEEN IMPORTING AND EXPORTING COUNTRIES AGREEMENTS CAN BE PROPERLY ENFORCED. IT IS MY JUDGEMENT AND EXPERIENCE THAT MEXICO IS SERIOUS ABOUT ENFORCEMENT AND WOULD TAKE THE NECESSARY ACTION TO PREVENT TRANSSHIPMENTS.

NAFTA'S STRICT RULES OF ORIGIN AND ENHANCED ENFORCEMENT MECHANISMS, ALONG WITH AUDITS BY CUSTOMS OF IMPORTERS AND EXPORTERS, WILL MAKE MEXICO UNINVITING TO TRANSSHIPPERS. I AM MORE CONCERNED ABOUT POTENTIAL TRANSSHIPMENTS THROUGH ISRAEL; PARTICULARLY SINCE ISRAEL RECENTLY SIGNED A FREE TRADE AGREEMENT WITH CHINA. CHINESE FABRIC MAY ENTER ISRAEL DUTY-FREE, AND THE APPAREL MADE FROM THAT FABRIC CAN BE SENT TO THE UNITED

STATES DUTY-FREE. GIVEN THE CHANGE IN CIRCUMSTANCES SINCE THE U.S.-ISRAELI FREE TRADE AGREEMENT WAS SIGNED, AND CONSIDERING THE HEIGHTENED RISK OF TRANSSHIPMENTS, THE NAFTA TEXTILE RULES OF ORIGIN AND ENFORCEMENT PROCEDURES SHOULD BE USED WITH ISRAEL AND ALL OTHER COUNTRIES WITH WHICH WE NEGOTIATE FREE TRADE AGREEMENTS.

MR. CHAIRMAN, ON BEHALF OF FRUIT OF THE LOOM, I WANT TO THANK YOU FOR HOLDING THESE IMPORTANT HEARINGS AND FOR LISTENING TO MY VIEWS.

Mr. SPRATT. Mr. Bodner, why isn't that adequate, if we got the data identified and substantiated under oath, under something like what is 18 U.S.C. 1001, false entries statute? Why isn't it adequate as opposed to having 2.4 million import licenses processed and issued? Why wouldn't that give us just about the same results?

Mr. BODNER. Under some circumstances, it might. It would depend in part on how far ahead of the trade that information is required to come in. If the document comes in 5 days before the ship, nothing's going to happen. You need to have enough time in here for people to process these masses of information. And I appreciate the reference to the number, and I said in my statement that you really might not need to do this across the board with all countries all at once. It would be a big undertaking, instituting a big apparel import licensing system or textile and apparel licensing system. It is a big job.

But I think there are some places that are easier to do than others for starters. I think the real question is whether under the system they are now using they have enough reach and enough warning to exporters and to importers as to what they are required to do to make it work. I am not clear in my own mind who fills out those forms, for that particular document, if that is a Customs broker as opposed to an importer in fact.

When I say importer in fact, for example, I mean the American retailer who is going to take those goods and sell them. Not a Customs broker. Not an import wholesaler who may pass the goods through his warehouse and then into the hands of a retailer. You have to get to people who are not necessarily a part of the import trade, but who are putting up the money for the goods. Now, the ELVIS system won't do that.

Mr. SPRATT. Why is that?

Mr. BODNER. I don't think they handle those documents. I don't think they are required to say on those documents where they are—I will be happy to be corrected on that. On ELVIS, is the importer, in fact, the filer or is it a broker or could it be anybody?

Mr. SORINI. It could be either.

Mr. BODNER. It could be either. It may be that the system needs to be adjusted, but I also heard they are only using it in a very limited way.

Mr. SPRATT. Well, ELVIS, it seems to me, is subject to the same problem as your import visa licensing system is, that yours still depends on some visual followup, because the applicants for a license can still, except in the most flagrant cases like UAE claiming to make knitwear shirts, can still misrepresent the facts. And unless you have got commercial officers in abundance in your embassies who are willing to do it, you are not going to be able to investigate 2 million visa applications and see if the facts correspond to the representations.

Mr. BODNER. To some extent, you have a people problem no matter what you do. You have to have enough people to look at it. In terms of the way these systems work, what I have in mind would be closer to what was done with the NAFTA in that sense. And we all worked with the government on that and were looking at the kind of certifications that are now made routinely by manufacturers under the Textile Fiber Identification Act. People know where

their sources are. So if an importer would say not just that I believe these goods' origin is China, but, "I know the factory in which these goods were made, here is the name of the factory, we have visited this factory, we have firsthand knowledge of what is in this factory, they have this capacity, they made these goods," he is getting in deep, if you will. So that you have some effect of just how far a guy is going to say, well, this is pretty casual, I will just stamp it and send it out. The guy whose name is on the document is the one who takes personal responsibility.

I don't think you get that now in the fast flow of entry documents.

Mr. SPRATT. So that is what you are looking for, is really pinning the donkey's tail on somebody for—

Mr. BODNER. It has to be a donkey's tail, and we have to establish it. And it has got to be located someplace here.

Mr. SPRATT. If you don't have a licensing system, then you don't have an occasion for requiring the importer to come in and declare these facts under oath. But if you can do it by another means, that is the key element that you are seeking, is to get that substantiation under oath.

Mr. BODNER. Big part of it. And if you had a licensing system, you have a mechanism at hand to get a foreign government to issue a back-to-back license. So you have a foreign government putting a similar burden on its own exporter to match that license and match that information flow. So you have a built-in enforcer who has some obligation.

Mr. SPRATT. Is a licensing system legal or permitted under GATT and under the multifiber arrangement?

Mr. SORINI. Well, the European Community does do that now. They have what is called a dual-licensing system. The exporting country, like with the United States, has to issue a visa, but also the importer has to obtain a license. I think the issue is whether it is an automatic license or a discretionary license. If the government has discretion in issuing a license to the importer, then it would probably not be legal under the international system. But if the government is obliged to grant the license, provided all the information on the license is correct—

Mr. SPRATT. So if you made it discretionary, but if you also provided that if your goods are licensed and the license is issued, they come through the ports on an expedited basis, then maybe lots of people will apply for it.

Mr. BODNER. Yes, there are two issues. I think, and I made this point in my prepared statement, as long as you are not using the license as a quota subterfuge device, you are OK. And in this case, there is no need to do that. You have an open quota system.

Mr. SPRATT. It is an information device.

Mr. BODNER. That is correct. And I think when you look at the language of the multifiber agreement and even the GATT transition arrangement, there is so much international support for doing something about transshipment, it would be very awkward for somebody to come back to you and say internationally you can't do this because it is a license. Well, it is not a quota, it is a license to enforce a quota and prevent transshipments and we are obliged to do that under these agreements.

Mr. SPRATT. Mr. Horn.

Mr. HORN. Thank you, Mr. Chairman.

Let me ask Mr. Sorini this question. It follows a little bit along the line of the previous discussion. Is there any evidence that Chinese transshipments to Europe are of similar, greater, or less proportion of total imports of textiles than they are for the United States?

Mr. SORINI. It is probably equal to or greater. And I can say that because we also have production facilities in Europe where we are the largest employer in Ireland. Our manufacturers there also feel the brunt of the transshipments in that market. The European Community is only beginning to start an enforcement task force to deal with transshipments. They have come up with the TAFI program, the textile apparel fraud initiative. But I would have to say from what we are seeing in the market, it is equal to or greater.

Mr. HORN. Do any of you have any other comments on that?

Mr. BODNER. Yes, we had a meeting in Brussels of the European and American and other textile people. There were some Japanese. This was about 3 months ago on what we chose to call the fundamental principles of trade for this area. And one of the things driving the European concern was the growth of transshipment problems. The European industry at large is very, very concerned about their problem with transshipments. They even produced a T-shirt for distribution at a press conference which was drawn from a U.S. Customs chart that had been made up. But they have got the problem in a big way.

Mr. SORINI. Could I just add a point, because I wouldn't want anyone to draw the conclusion that because the EC has an import-licensing system, that it does not work in stopping the transshipment problem. The complaint of manufacturers in Europe is that the commission is not using the import-licensing system to address the problem. They do require an import license. They do require all the information be on the document, but they file the document away and don't followup.

They are not doing jump teams. Jump teams are extremely important. When the document is issued by the importing country, the authorities must get on airplanes and go verify production in the claimed country of origin. And that is what Customs is starting to do, and that is what the European Community has not been doing.

Mr. HORN. Thank you. We have been talking a lot about what government ought to be doing to stop and get at the transshipment problem. Another approach would be for legislation to be passed to give a private right of action to those that have been harmed by transshipment. Has that been discussed among labor, industry, at all? And if so, what are your conclusions?

Mr. BODNER. There has been discussion for years about private rights of action. None of those discussions have got too far because the sentiment on the Hill doesn't seem to go that far. I would think the problem with it is this inevitable causation difficulty. When your factory is closed and you are the worker, you are not too sure whether it is transshipment, legal shipment, which shipment it was.

Who would decide the economic impact of a transshipped sweater as opposed to a cheap sweater from somebody who had a quota? Very difficult to deal with. I think that has really been the kind of stumbling block that we see.

Mr. HORN. Any other reaction?

Mr. BREMER. I can only report, Congressman, that ATMI for several years has supported private right of action for injured U.S. citizens or associations and groups representing them.

Mr. HORN. Let me ask you a question with regard to the North American Free Trade Agreement. I know labor is probably opposed to it; industry, some of them are probably for it. In the textile area, do you feel the implementation of that agreement as now negotiated by the Congress would be helpful to solve some of your problems, or what? I would just like to go right down the line.

Mr. BREMER. Thank you, sir. It is ATMI's considered opinion that the enforcement measures in NAFTA are very strong and that Customs will devote the necessary resources to see that the terms and conditions of NAFTA are followed closely. Following up on something that Commissioner Banks mentioned this morning, ATMI stands ready to assist the Customs Service in this regard.

In Mexico, it is the law; we wish it were the law in the United States that every textile mill must belong to its national trade association and every apparel manufacturer must belong to its national apparel manufacturers association. Those two organizations therefore have a comprehensive list of every textile mill and apparel manufacturing plant in Mexico.

I think that should be—and it would be—provided by those organizations to Customs and then put into their data base. Similarly, those firms that do not represent domestic producers but operate the maquiladoras have a similar association.

What I am proposing, sir, is that the identity of every legitimate manufacturer in Mexico can be made available to the United States Customs Service and input into their computer program. And the first guy who tries to export from Mexico or import from Mexico from somebody whose name is not on that list, the goods should be delayed while an investigation is conducted.

Mr. HORN. Mr. Sorini.

Mr. SORINI. Well, we are comfortable with what is in the text, and we are certainly comfortable with the desire of the Customs Service and the Commerce Department who want to enforce the agreement. I think the key issue is how it is dealt with in the implementing legislation and how do you clarify some of the questions that were raised earlier about whether an importer is held culpable if he puts misinformation on the document. But we think that NAFTA goes a long way to addressing the problem and would make Mexico uninviting to transshipments.

Mr. HORN. Mr. Starobin.

Mr. STAROBIN. It should not be surprising that our view is diametrically opposite to that of the last two statements. I think there are two factors involved. No. 1, there is evidence of American companies, one in particular, setting up a joint venture in Mexico to make denim, which has to lead to a loss of jobs in this country. We know of a Chinese company in a joint venture with an American

company setting up or planning to set up a vertical operation in Mexico, financed, incidentally, with our taxpayers' money.

Mexican Export-Import Bank money that normally would be used to pay off debt to the United States is now being used to help finance this company in Mexico. The issue of NAFTA to us is a jobs issue. It is as simple as all that. NAFTA, in the minds of the textile industry, may protect it. But it will not protect American jobs, either in textiles in the long run, which may be much shorter than the long run, in apparel.

Experience has shown that American companies who first started moving to Asia in search of lower wages have taught the whole world a lesson. And that is continually go to countries where wages are lower, where there are totalitarian regimes, and I classify Mexico as one such regime that does not carry out its own laws, does not enforce its own laws, be they with respect to the political structure or minimum wages or any other labor standards or any environmental standards. If Mexico even made an effort to raise its wages and enforce its own labor standards, American companies would move to other areas with even lower wages and less enforcement.

Recent articles have appeared in the press, particularly one last Wednesday in the New York Times, that showed that Mexico's labor standards are an absolute farce. If jobs are the issue in America, then NAFTA cannot help America.

Mr. HORN. Isn't the reality, though, that all of this has happened without NAFTA? Why should it be better with no NAFTA?

Mr. STAROBIN. That is interesting. Mr. Kantor asked me the same question back 8 months ago. And what came to my mind is that if you are going down a hill toward a precipice, do you step on the gas or do you step on the brakes? Do you try to stop, do you try to preserve jobs in our country?

The virtue of NAFTA to American manufacturers is that it is a guarantee, a better guarantee than what they have had until now. Now they have a bunch of amorphous Mexican laws which invariably are not carried out except in a negative sense. NAFTA would provide the kind of assurance they are looking for. I think that is the fundamental difference between the fact that companies may be moving now, and the flood that will really begin if NAFTA is approved by the Congress.

Mr. HORN. As you know, right now, I am not going to argue NAFTA with this because you are not going to change my mind. I am not going to change yours, but reality is right now a number of firms and plants have to locate in Mexico to sell in the Mexican market. And here is 90 million people, 3 times the population of California, that is a market. And I just wonder, is America sort of drifting backward, that they no longer are interested in competing in a global market and selling textiles to Mexico?

Let me give you an example. One of our distinguished citizens who was born in Chihuahua, Mexico, in my congressional district now, described how when her wedding occurred she sneaked across into Texas, bought her bridal gown there, and she says every Mexican bride in the middle class does the same thing, and smuggles it back into Mexico.

Now, it is United States textiles, probably with the ILGW label on that, that move into Mexico. Now, you know, there is a market there is all I am saying.

Mr. STAROBIN. Well, the question is what kind of market you are really talking about. I tried to indicate in my testimony, both the written and the oral testimony, that a very detailed analysis of Mexico's market shows that it is far less than we have claimed it to be. There is a market there, there is no question about it. Out of the \$40 billion that Mickey Kantor claims goes into Mexico's consumer market, only \$8 billion really goes in. If you take that \$8 billion and divide it by 90 million Mexicans, you have less than \$90 per capita.

And, if you take it one step further and divide that by 365 days, the average Mexican buys the equivalent per capita, with all the limitations of what per capita means, 25 cents a day, the equivalent of maybe one or two Pepsi-Colas a week. There is no substantial consumer market in Mexico. In addition, it is of some interest that when you break down the detail, in 1992 we had an unfavorable trade balance with Mexico in precisely the consumer goods that we are talking about. In those same goods, Mexico shipped us \$9.3 billion or \$1.3 billion more than we shipped to Mexico.

I have tried to suggest to you, sir, that our government is using inaccurate figures. We are using them to make a point and I think the point is absolutely incorrect. I could call them fraudulent figures, but I am trying to be polite, so I call them inaccurate. They are inaccurate, they are fraudulent because the government has been aware of the inaccuracies. The prior administration and the current administration, Mr. Sorini's office, Ms. Hayes' office, know this in the past, and the GAO now shows the same thing. And the GAO is your agency. It points out a very different picture than the one that has been used.

A consumer market may exist, but it is far less than what we suppose it to be. It is minuscule compared to what we suppose it to be. It is less than 20 percent of our alleged exports to that market.

Mr. HORN. Well, I am going to give Mr. Bodner a chance, and I don't want to delay the chairman, but—

Mr. SPRATT. I think we could have a fascinating debate, but I think it is for another day.

Mr. HORN. Mr. Sorini, you seem to be an unindicted coconspirator.

If you want equal time, go ahead.

Mr. BODNER. He is the original conspirator. I will attempt to confine myself just to the narrow part of your question, without launching into a strenuous and vigorous support, I would hope, of Herman's comments.

I happen to agree and our association is very much opposed to NAFTA, not, I hasten to add, because of the details of the origin rules or the minutia of the agreement. I think, and I have said this before, those are rather well done.

There is a real problem, however, and we should not fool ourselves, with the ability of the Customs Service to do all this. Mr. Banks and any Customs official who is going to sit up here and testify about how many Customs inspectors he really needs to do that

is going to tell you that he is going to be able to carry out the law come hell or high water, because what else can he say? But the fact is they are transferring, already they are talking about adding 350 people to the border area, and they are talking about a 700 to 1,000 person head count cut elsewhere in the system, so you are getting into some sizable numbers for an agency that in anybody's objective view has had its workload grow enormously, faster than its resources have grown.

Now, in addition, Commissioner Weise, who really has a wonderful approach to things in my opinion, has launched a new organizational or reengineering approach that is going to take 6 months. Well, I don't know whether you have run any kind of Federal bureaucracy or been involved in it, but one of the things you do when you start reorganizing a Federal bureaucracy, is you slow it down. No matter how good your intentions are, people whose positions are being reorganized tend to get very jumpy.

If you are in a big office like the Customs Service, you have reason to be jumpy because you could get transferred from some great place where you like to live to some great place where you really don't want to go. So you have all of those kinds of ordinary human personnel concerns. You have this enormous systems complexity that they talk about, and new systems being loaded all the time, and now we have NAFTA. And we are supposed to believe that they are going to be able to rush out and carry all this out in a very short period of time, when there is \$2 billion worth of stuff coming out of China a year and they can't find it? I just think it is too much to accept.

Mr. HORN. Mr. Chairman, I don't know if you want to have the staff work out those questions that perhaps some of my absent colleagues and yours have not asked that might want to be submitted for written answers, but maybe they could work it out. And Mr. Cox might want to include his opening statement.

Mr. SPRATT. We will say that to all the witnesses, most of whom have left by now, that we may have some questions for the record and we would appreciate your assistance in answering them for the record if we do. Thank you very much for coming, for testifying, for your forthright responses and your expert responses and above all and not the least, for your forbearance in waiting to testify as a part of the last panel.

[Whereupon, at 2:09 p.m., the subcommittee adjourned, to reconvene subject to the call of the Chair.]



APPENDIXES

APPENDIX 1.—NOVEMBER 17, 1993, AND JANUARY 7, 1994, LETTERS FROM CHAIRMAN SPRATT TO CUSTOMS SERVICE AND RESPONSES FROM CUSTOMS SERVICE

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November 17, 1993

Mr. Samuel H. Banks
Acting Deputy Commissioner
U.S. Customs Service
Washington, DC 20299

Dear Mr. Banks:

Thank you for testifying before the Commerce, Consumer, and Monetary Affairs Subcommittee of the Committee on Government Operations. Your testimony during our oversight hearing was quite informative and I appreciate the time you devoted to the hearing. Given the substantial subject matter involved with the oversight hearing, we did not cover all the points that we wanted to explore. The following information requests and questions are being submitted to you as an extension of the hearing so that your responses can be incorporated into the record.

1. CFO Act Implementation. We were pleased to learn that Customs is committed to implementing the reporting requirements of the Chief Financial Officers Act of 1990. The subcommittee would like to have a schedule that describes a specific timetable for the preparation of financial statements that Customs expects will be able to receive an unqualified opinion by the General Accounting Office. We are primarily interested in knowing when the areas outlined in GAO's statutory report, e.g. tariff collections, accounts receivable, seized property, and data used to compile trade statistics, will be based on financial statements for which GAO can give an unqualified opinion.

In addition to a timetable for the preparation of financial statements, we would like to have the action plan that will be used to meet the timetable for preparing the financial statements. The action plan should list the time frames for the various Customs offices to implement the specific changes (i.e. action items) necessary for the preparation of accurate financial statements. The schedule of action items and the overall timetables for preparing financial statements will give us performance standards by which we can judge Customs performance in implementing the CFO Act of 1990. The statement you provided for the record in our hearing was helpful but did not contain specific timetables and action items that could be used as performance standards. If such a plan has not been developed, we

would like to know when one will be available and how goals for implementing the Chief Financial Officers Act are now being pursued.

2. Revenue Shortfalls. The lack of internal controls in the Customs Service for identifying merchandise entering the United States prevented GAO from having any assurance that the \$20.2 billion received represents all the revenues Customs should have collected in 1992. Please give us your estimate of the shortfall in revenues and how much of that shortfall can be corrected by fully implementing the CFO Act of 1990. Please provide an estimate of when the revenue collection procedures will be in place so that auditors will have sufficient assurance that the corresponding revenue statements are correct.

3. Drawbacks. The GAO could not give any assurance that the \$496 million in 1992 drawback claims were valid because of serious control weaknesses in the drawback process. GAO also noted that the Customs Service has plans to revise the drawback system but the revisions have a low priority in Customs. Please provide an estimate of the number and amounts of both fraudulent and invalid drawback payments. Also provide an explanation of the finding that the revisions to the drawback system have a low priority for Customs. Please provide an estimate of the time in which the planned revisions will be completed.

4. Seized Assets. During your testimony you indicated that the Service has taken steps to correct procedures for handling seized guns and drugs. Please describe those procedures, the locations at which they are in place, and what steps are being taken to assure that they are being followed at each of the locations.

5. Over Assessed Fines. The testimony of the GAO indicated that the current penalty and fine assessment practices of the Customs Service may diminish Customs' credibility and deterrent effect. GAO pointed out that during the last 2 years Customs assessed fines and penalties which totaled approximately \$7.9 billion but only collected about \$87 million, including cases opened in earlier years. GAO found that Customs frequently did not have adequate documentation for its assessments and mitigated the amounts to reflect documentation later provided by the importer.

Is the practice of making very large assessments initially and then reducing the assessments necessary? How could the process be made more efficient? It does not appear reasonable to repeatedly charge importers with fraudulent behavior and then dropping the allegations. Do these practices have any deterrent effect? Do such large adjustments to initial assessments result in erroneous mitigations or losses? Also provide an explanation of how Customs agents individually and the agents' work units are rated for performance purposes. Specifically, how do assessments and final collections fit into performance reviews? Are there any restrictions on using assessments in performance reviews and where can they be used? How could performance standards be changed to better reflect more efficient practices?

6. Shortening Audit Cycles. During your testimony you indicated that it would improve Customs' deterrence efforts if the Service could move from a 25-year audit cycle for large importers to a 5-year cycle. You indicated that there are a variety of audits that could be conducted more frequently, e.g. compliance audits for foreign trade zones and bonded warehouses, fraud audits and national audits. Please provide a description of the makeup of a 5-year audit cycle and how it would differ from current audit activity. Also provide a description of the types of management changes that would be necessary to achieve the 5-year audit cycle. Please include recommended changes to statutory requirements for Customs staff functions, modernization programs that would require statutory authority, additional funding and management changes within Customs current authority.

7. Restructuring Penalties. During the hearing there appeared to be a general consensus that the current penalties for transshipping textile and apparel products into the United States were not sufficient to deter the activity. Please describe the penalties that are currently in place for the parties that can be involved in transshipping such as exporters, brokers, wholesalers, and retailers, and then suggest revisions to those penalties that would provide greater deterrence.

8. Enforcement Levels. Recent press accounts indicate Operation Q-Tip has had two separate prosecutions resulting in seven separate convictions. Given that the value of transshipments entering the United States are in the billions of dollars, why are the number of prosecutions so small? What changes in the law would facilitate increased prosecutions? If you expect prosecutions to increase, please indicate when and by how much.

Again, I appreciate the efforts you have shown us in pursuing the oversight jurisdiction of the subcommittee. I hope that the additional information can be obtained quickly and look forward to your response.

Sincerely,



John M. Spratt, Jr.
Chairman

JOHN COVATTA, JR., MICHIGAN
CHAIRMAN

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ONE HUNDRED THIRD CONGRESS

Congress of the United States

House of Representatives

COMMITTEE ON GOVERNMENT OPERATIONS

2157 RAYBURN HOUSE OFFICE BUILDING

WASHINGTON, DC 20515-6143

Subcommittee on Commerce, Consumer, and Monetary Affairs

B-377 Rayburn House Office Building, Washington DC 20515-6144

Majority: (202) 225-4407

January 7, 1994

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INDEPENDENT

MAJORITY—(202) 225-4081
MINORITY—(202) 225-6076

Mr. Samuel Banks
Deputy Commissioner
U.S. Customs Service
1301 Constitution Avenue, NW
Washington, D.C. 20229

Dear Mr. Banks:

As a follow-up to our subcommittee hearing on transshipments, I would be grateful for more information on Customs personnel levels over the past two decades. A long-standing concern of my subcommittee has been that the federal government provides the Customs Service with inadequate resources to accomplish its enormous responsibilities. For example, even though the volume of U.S. exports and imports has expanded exponentially over the past two decades, Customs personnel and resources have not kept pace. In that context, I would like tables showing Customs' work force levels for the following years: 1973; 1977; 1982; 1987; 1993 and projected figures for 1994. It would be most useful if these figures were broken down into job functions. Should that be too burdensome, I am most interested in the number of individuals working as inspectors, import specialists and agents. In addition, it would be helpful to learn how many of these employees worked full-time and how many part-time on textile enforcement issues. Please also provide information on the number of Customs personnel working on Operation Q-Tip and the number who will be working on Q-Tip after the resources pledged by President Clinton are provided. Please indicate where you believe additional resources or manpower would be helpful. I would like for the same years, 1973, 1977, 1987 and 1993, the total value of imports entering the country. Those figures will help us compare the increase in volume of cargo you must inspect with personnel figures at very times.

You know, of course, about the pledges made by President Clinton in his November 16, 1993 letter to me and nine other Representatives for additional Customs personnel and resources. My colleagues and I take those pledges very seriously and I would like to know: 1) the date when the additional 136 employees will be hired; 2) what their job responsibilities will be; 3) how the additional \$15 million will be spent; 4) the date when

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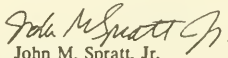
this money will be available; Since the NAFTA went into effect on January 1, 1994, Mexican textile manufacturers are already taking advantage of the new import rules and the need for the additional resources is immediate.

Finally, President Clinton pledged in his letter to issue by April 1, 1994 proposed regulations for extension of the redelivery period, changes to the mitigation guidelines and issuance of certificates of origin/textile declarations on non-NAFTA qualifying shipments. Please provide our subcommittee with a copy of these draft regulations and let us know what stage in the drafting process are these proposed regulations.

Since the answers to the questions I raise are important for upcoming hearings we are considering, I would be grateful if you could provide this information no later than February 4, 1994.

Thank you for your cooperation. Please feel free to call me or Tom Kahn should you or your staff have any questions.

Sincerely yours,


John M. Spratt, Jr.
Chairman



DEPARTMENT OF THE TREASURY
U.S. CUSTOMS SERVICE
WASHINGTON, D.C.

FEB 3 1994

ADM-2-OM:H

The Honorable John M. Spratt, Jr.
Chairman
Subcommittee on Commerce, Consumer,
and Monetary Affairs
Committee on Government Operations
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

This is in reply to your letter of January 7, 1994, to Acting Deputy Commissioner Banks. In your letter, you raised specific concerns and requested additional information regarding Customs personnel levels over the past two decades. This request is a follow-up to the subcommittee hearing on transshipments.

In order to be fully responsive to your inquiry regarding Customs personnel levels over the past two decades, we are currently reviewing and researching the matter. We will provide you with a more detailed reply as soon as possible.

Please be assured that your request will be addressed in an equitable manner. Your interest in the U.S. Customs Service is appreciated.

Sincerely,

C. D. Brainard
Assistant Commissioner
Office of Management



DEPARTMENT OF THE TREASURY

U.S. CUSTOMS SERVICE

WASHINGTON, D.C.

February 15, 1994

BUD-1-OM:C:B:F CJ

The Honorable John M. Spratt, Jr.
 Chairman
 Subcommittee on Commerce, Consumer,
 and Monetary Affairs
 Committee on Government Operations
 United States House of Representatives
 Washington, D.C. 20515

FEB 14 1994

 COMMERCE, CONSUMER &
 MONETARY AFFAIRS

Dear Mr. Chairman:

I am writing in response to your letter of January 7, 1994. In that correspondence, you requested information on past Customs personnel levels and the status of President Clinton's pledge to add Customs personnel and resources for textile and apparel enforcement activities. In addition, you requested information on the status of proposed regulations regarding redelivery periods, mitigation guidelines and certificates of origin/textile declarations.

Enclosed is information on the following issues:

- (1) Summary of Customs work force levels for inspectors, import specialists, agents, and auditors for 1973, 1977, 1982, 1987, 1993, and projected estimates for 1994;
- (2) Data on personnel working on textile enforcement issues;
- (3) Issue papers on resources or manpower for textile enforcement activities; and
- (4) Data on the total value of imports entering the U.S. for 1973, 1977, 1982, 1987, and 1991.

The additional resources pledged by President Clinton are included in Customs Service Fiscal Year (FY) 1995 Budget request. However, I am happy to inform you that Customs is making every effort to provide funding for these resources in FY 1994 to accomplish the goals of the textile enforcement program. As you are aware from earlier hearings, identifying textile and other NAFTA violations is a complex undertaking, requiring experienced and knowledgeable staff for effective enforcement. Therefore, we are planning to shift on-board experienced import specialists, agents,

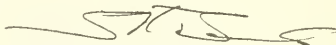
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inspectors and auditors to those areas experiencing high volume textile imports and to ports where transshipment violations are occurring. Geographically, primary locations will be along the Southwest Border, major airports and seaports, and to ports deemed vulnerable to violators involving other products, such as beef, peanuts, etc. In anticipation of Congressional approval of the \$18 million initiative in our FY 1995 request, Customs will begin recruitment for these new positions in FY 1994. This preparation will enable Customs to fill the new additional positions by October 1, 1994, and to be fully operational at the start of FY 1995.

Finally, I am pleased to inform you that Customs is in the process of drafting the regulatory proposals highlighted in your letter and that the project is on schedule. The proposals must be approved by the Department of Treasury for publication in the Federal Register. At that time, we can provide the Subcommittee with approved copies of the proposals.

I very much appreciate your interest in the Customs Service. If you have any questions regarding this information, please contact me at your earliest convenience.

Sincerely,



Samuel H. Banks
Acting Deputy Commissioner

SUMMARY OF EMPLOYMENT
DIRECT FULL TIME EQUIVALENT POSITIONS \1

	FY 1973	FY 1977	FY 1982	FY 1987	FY 1993	FY 1994 est.
INSPECTORS	3,472	3,943	3,987	4,386	5,983	6,230
AGENTS and PATROL OFFICERS	1,692	1,968	1,693	2,089	2,342	2,387
IMPORT SPECIALISTS	1,304	1,204	1,081	966	1,140	1,169
AUDITORS	--	--	137	204	360	360
ALL OTHER	<u>4,931</u>	<u>5,738</u>	<u>5,646</u>	<u>5,607</u>	<u>6,832</u>	<u>6,958</u>
TOTAL FULL TIME	11,399	12,853	12,544	13,252	16,657	17,104
PART TIME and TEMP	<u>373</u>	<u>375</u>	<u>380</u>	<u>719</u>	<u>550</u>	<u>550</u>
AGENCY TOTAL	11,772	13,228	12,924	13,971	17,207	17,654

1\ Does not include any user fee reimbursable programs such as COBRA, OCDETF, Puerto Rico, Small Airports, Carrier Hubs, etc...)

WORKING ON TEXTILE IMPORTS

Based on a recent survey of Customs Import Specialist Teams throughout the country:

Number of Import Specialists

Full-Time	235
Part-Time	<u>185</u>
Total	420

ENFORCEMENT RESOURCES DEVOTED TO OPERATION Q-TIP

	<u>Work Hours</u>	<u>FTE</u>
FY 1991	19,154	9
FY 1992	100,558	48
FY 1993	56,306	27

The data for resources in FY 1994 are unavailable because the amounts of additional resources to be used in textile enforcement are not yet finalized. When they are made available, they will be disbursed to major port areas that have high incidences of textile fraud. The resources will not be devoted specifically to Operation Q-Tip. Agents are not entirely dedicated to work on textiles.

ADDITIONAL RESOURCES OR MANPOWER

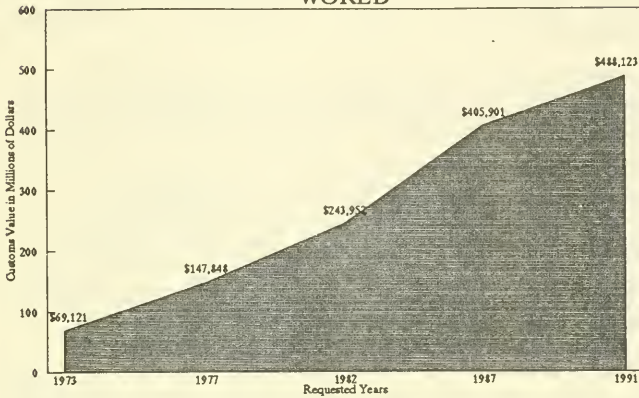
The Customs Service is currently undertaking a three part program to ensure effective enforcement of all textile imports, as well as, implementation of the new NAFTA regulations.

The first step has been to implement a comprehensive program for training of Customs staff nationwide. Second, Customs is in the process of enhancing its automated systems to improve targeting of potential violations, as well as preparing detailed information on textile import trends and countries. Finally, Customs will be recruiting and allocating the additional staffing resources directed to administering textile and NAFTA related imports. We anticipate that the current Customs resources devoted to textile enforcement activities, coupled with the requested enhancements in the FY 1995 budget, will be adequate for effectively targeting violators. Once the full trade enforcement system has been implemented, we will evaluate the results achieved.

**U.S. IMPORTS from...
WORLD**
(Customs Value in millions of dollars)

	<u>1973</u>	<u>1977</u>	<u>1982</u>	<u>1987</u>	<u>1991</u>	<u>1993</u> \a
TOTAL	\$69,121	\$147,848	\$243,952	\$405,901	\$488,123	Not Available

**U.S. IMPORTS FROM...
WORLD**



a\ Customs is currently in contact with U.S. Census to obtain FY 1993 data.



DEPARTMENT OF THE TREASURY

U.S. CUSTOMS SERVICE

WASHINGTON, D.C.

February 16, 1994

The Honorable John M. Spratt, Jr.
Chairman, Commerce, Consumer, and
Monetary Affairs Subcommittee
Committee on Government Operations
Washington, D.C. 20515-5143

FEB 16 1994

COMMERCE, CONSUMER,
AND MONETARY AFFAIRS SUBCOMMITTEE

Dear Mr. Chairman:

In response to your letter of November 17, 1993, Customs is providing in the enclosure the requested information relating to the General Accounting Office's Audit of Customs Fiscal Year 1992 Financial Statements.

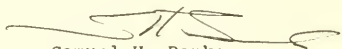
The enclosure provides responses to the eight specific issues raised in your letter. We have also enclosed for your review three substantive documents related to Customs plans for financial management improvement.

The first document is a comprehensive financial management improvement plan, which deals primarily with the development of financial systems essential to preparation of financial statements. The second document reflects a series of actions that Customs plans to take in response to General Accounting Office (GAO) recommendations for immediate actions that would improve financial management in key priority areas. The third document is our response to GAO's draft audit report relating to revenue (Customs ability to ensure that duties are properly assessed). This response addresses many of the concerns raised in your letter.

We have met with Mr. Tom Kahn of your staff and he indicated an interest in scheduling several briefings on specific subjects relating to our response. We plan to contact Mr. Kahn to schedule the briefings.

We hope that the enclosed documents as well as our briefings will convey to you the very strong commitment in the Customs Service to improve financial management. We appreciate your support and interest in our efforts. If you have any questions concerning the enclosed information, please have member of your staff contact Mr. William Lawrence of our Office of Congressional Affairs on (202) 927-1750.

Sincerely,


Samuel H. Banks
Acting Deputy Commissioner

Enclosures

1. Question: CFO Act Implementation.

The subcommittee would like to have a schedule that describes a specific timetable for the preparation of financial statements that Customs expects will be able to receive an unqualified opinion by the General Accounting Office. We are primarily interested in knowing when the areas outlined in GAO's statutory report, e.g. tariff collections, accounts receivable, seized property, and data used to compile trade statistics, will be based on financial statements for which GAO can give an unqualified opinion.

In addition to a timetable for the preparation of the financial statements, we would like to have the action plan that will be used to meet the timetable for preparing the financial statements. The schedule of action items and the overall timetables for preparing financial statements will give us performance standards by which we can judge Customs performance in implementing the CFO Act of 1990.

Response:

In June 1993 Customs received the General Accounting Office audit report disclaiming Customs fiscal year 1992 annual CFO financial report. The audit report presented findings in three summary areas, (1) adequacy of Customs automated systems, (2) adequacy of internal controls, and (3) existence of documentation supporting the data contained in Customs systems and Customs year-end adjusting entries.

In response to the audit report, Customs prepared a Comprehensive Financial Management Improvement Plan (Attachment 1) addressing each finding presented in the audit report. The Plan projects the earliest fiscal year in which interim solutions can be implemented and the fiscal year in which a particular finding can be fully corrected. The Plan also identifies the individual Task Force efforts underway such as Selectivity and Sanctioning.

Customs selected financial statement areas in which improvement could be shown for the fiscal year 1993 financial report. The fiscal year 1993 efforts concentrate on accounts receivable, property, plant and equipment, accounts payable and resolving disclosure issues. Customs is also developing a plan for completing a 100% inventory of seized property. GAO also provided information that identified areas where Customs could make improvements (Attachment 2) Customs has requested a waiver to the March 1, 1994, submission date for the fiscal year 1993 annual report and will be prepared to submit the audited financial statements on May 15, 1994.

Customs officials are meeting to select areas in which further improvement can be shown for the fiscal year 1994 financial reports. These areas concentrate on continuing efforts to improve accountability over seizure activity, implementing interim enhancements to the

financial systems, strengthening manual and automated controls, providing training to Customs managers to increase their understanding of how operational activities affect financial management abilities, and reviewing Customs internal assessment and management control systems.

Customs longer term activities include the implementation of a fully integrated automated system, with appropriate internal control safeguards, ancillary system interfaces to the general ledger, and accrual and cost accounting capabilities. This process is supported by the efforts to redesign Customs Automated Commercial System (ACS) by Customs Future Automated Customs Environment Team (FACET) and Automated Revenue Accounting (CARA) projects, and the enhancements to the general ledger accounting system as part of Customs' continuing AIMS Phase II plans.

Customs is also supplementing the CFO staff by filling six new accounting positions and detailing current staff to the CFO effort. Customs fully expects to comply with the March 1, 1995, submission date for the fiscal year 1994 audited financial statements.

The soonest Customs can realize its ultimate goal of achieving an unqualified opinion is with the fiscal year 1995 annual report. This will result from the commitment of our managers and employees to improving the financial condition of Customs, and the implementation of sufficient system improvements, strengthening internal controls and ensuring compliance with policies and procedures.

2. Question: Revenue Shortfalls.

The lack of internal controls in the Customs Service for identifying merchandise entering the United States prevented GAO from having any assurance that the \$20.2 billion received represents all the revenues Customs should have collected in 1992. Please give us your estimate of the shortfall in the revenues and how much of that shortfall can be corrected by fully implementing the CFO Act of 1990. Please provide an estimate of when the revenue collection procedures will be in place so that auditors will have sufficient assurance that the corresponding revenue statements are correct.

Response:

In anticipation of the Customs Modernization Act, and in an effort to improve operations, a new methodology to measure commercial compliance was tested in the last half of fiscal year 1993. Customs set out to measure the compliance for the importation and documentary processing of cars, trucks, and parts. In addition, Customs conducted compliance measurements of four other industries: steel, telecommunications, automated data processing equipment, and fiberboard.

The compliance measurement process is a valid measurement of potential revenue shortfall. As a result of the first five measurements taken, a 2.1 percent revenue gap shortfall was identified collectively across the five industries. Action is being taken in each of the five industries to recover revenue.

In conjunction with the trade enforcement strategy, each Customs District is conducting a local compliance measurement test this fiscal year. Fifteen commodities will be tested this fiscal year on a local basis. Later this year, a national compliance test on a commodity will also be conducted.

In addition to measuring the revenue gap of the entry/entry summary process, we have begun to measure the quality of the initial inventories reported to Customs on bills of lading. A vessel bill of lading compliance measurement test is currently underway in nine East Coast Ports from Boston to Miami. This test will conclude shortly, and the revenue gap from bills of lading calculated.

Compliance measurements of both bills of lading and manifests will commence in early calendar year 1994 for Gulf and Pacific ports. In this way, we will measure both the quality of the ship's bill of lading and the quality of individual manifests to verify quantity and associated revenue. By the end of fiscal year 1994, a complete measurement of vessel bill of lading and manifest compliance, including the revenue gaps associated with each, will be concluded.

Compliance measurement may also expanded to such areas as in-bond, bonded warehouses, foreign trade zones, and drawback, enabling Customs to measure the potential revenue shortfall in these areas.

Many of the issues related to revenue are more fully discussed in Attachment 3, which contains the recent Customs response to GAO's draft report on financial management.

3. Question: Drawbacks

The GAO could not give any assurance that the \$496 million in 1992 drawback claims were valid because of serious control weaknesses in the drawback process. GAO also noted that the Customs Service has plans to revise the drawback system but the revisions have a low priority in Customs. Please provide an estimate of the number and amounts of both fraudulent and invalid drawback payments. Also provide an explanation of the finding that the revisions to the drawback system have a low priority for Customs. Please provide an estimate of the time in which the planned revisions will be completed.

Response:

Customs does generally agree that the current drawback system requires substantial improvements to achieve the goals outlined by the GAO. Corrective actions are already underway. The new automated drawback system will insure greater processing efficiency and more effective verification of claims, reducing the possibility of fraudulent or invalid claims. An in-house task force is developing a comprehensive automation strategy for the new drawback system. This task force is currently operating on a priority basis. Completion of the project is dependent upon available resources and the overall agency automation plan.

In the interim, Customs has implemented several actions to better protect against potential fraudulent or invalid claims. For all Accelerated drawback payment claims, Customs will institute more stringent review and verification of requests. We believe that this interim measure will provide sufficient protection until the automated system is operating.

Finally, we agree with GAO that it is not possible to assess potential and ongoing revenue losses from these claims. Currently, suspect claims are referred to Customs investigators, and if the claim is not valid the drawback refund is denied. However, pinpointing such claims is exceedingly difficult. To correct these shortcomings, Customs is currently planning to introduce a comprehensive Compliance Measurement System by Mid-year. Our experience with import compliance measurement based on statistical sampling indicates that it would greatly enhance our capability for targeting potential violations as well as implementing effective operational control over the drawback program.

4. Question: Seized Assets

During your testimony you indicated that the Service has taken steps to correct procedures for handling seized guns and drugs. Please describe those procedures, the locations at which they are in place, and what steps are being taken to assure that they are being followed at each of the locations.

Response:

The Customs Service is currently working very closely with the General Accounting Office (GAO) to correct deficiencies identified in their report. GAO has provided Customs with a set of detailed actions required to improve the operations and physical security of Customs Seized Assets Program. A detailed list of the actions proposed by Customs are included in Attachment 2. We are currently undertaking extraordinary efforts to comply with GAO recommendations and to insure that our controls over seized drugs and weapons is consistent with this effort.

As you will note in Attachment 2, Customs is undertaking a 100% inventory of seized property and upgrading existing storage facilities or constructing new facilities, if needed, to insure proper physical safeguarding of the seized property. We believe that these actions will enable us to improve the physical and management control of the seized property as well as the accountability for the property. In addition, Customs has implemented procedures to insure secure handling of all seized property, including firearms and narcotics. New procedures have been established at all locations to insure secure handling and disposition of seized property and narcotics. Destruction of seized narcotics must now be countersigned and witnessed by at least two Customs officers. Periodic oversight inspections will be conducted to insure compliance with these directives.

5. Question: Over Assessed Fines

The testimony of the GAO indicated that the current penalty and fine assessment practices of the Customs Service may diminish Customs' credibility and deterrent effect. GAO pointed out that during the last 2 years Customs assessed fines and penalties which totaled approximately \$7.9 billion but only collected about \$87 million, including cases opened in earlier years. GAO found that Customs frequently did not have adequate documentation for its assessments and mitigated the amounts to reflect documentation later provided by the importer.

Is the practice of making very large assessments initially and then reducing the assessments necessary? How could the process be made more efficient? It does not appear reasonable to repeatedly charge importers with fraudulent behavior and then dropping the allegations. Do these practices have any deterrent effect? Do such large adjustments to initial assessments result in erroneous mitigation or losses? Also provide an explanation of how Customs agents individually and the agents' work units are rated for performance purposes. Specifically, how do assessments and final collections fit into performance reviews? Are there any restriction on using assessments in performance reviews and where can they be used? How could performance standards be changed to better reflect more efficient practices?

Response:

The issue of the disparity between the initial assessments of fines and penalties and the mitigations ultimately afforded importers has historically existed for a variety of reasons: a tradition of sternly penalizing wrongdoers, an abiding interest in ensuring that Customs is able to collect a large penalty if the violation proves to be more egregious than initially thought and an interest in ensuring an importer's cooperation in resolving a case since the importer must carry the assessment as a contingent liability of the firm. Finally, some of the high proposed amounts are required by statute or implementing regulations.

Customs has traditionally sought to protect the revenue and ensure collection of eventual fines and penalties by operating in the manner noted by the GAO. Initial facts available with regard to a potential violation are rarely those upon which the final penalty is based. The penalty reflects our consideration of additional information presented by the violator. We do not believe that this practice has resulted in erroneous mitigation or losses.

Customs is now preparing to implement the provisions of the Customs Modernization Act. This Act will change the agency's basic philosophy from one that is penalty-driven to a partnership with the importer. We recognize that our penalty system will require overhaul because of the new burden on the public and are exploring a more rational system that will consist of a series of three actions: counseling, first time offense, final offense--a "three strikes and you're out" system. Knowing that the importer has an informed compliance burden will enable us to assess penalties that are more accurate and appropriate.

With respect to your queries about the ratings of our personnel, we assume that you

are concerned about those employees who are assessing and mitigating penalties. Generally, those employees work in the Fines, Penalties and Forfeitures Offices of Customs Districts and are not "agents" by job title, nor do these employees initially appraise all of the merchandise subject to penalty. If an appraisal is needed it is done by an import specialist who does not work for FP&F.

FP&F personnel generally ensure that the procedural aspects of a case are followed. They analyze submissions made by the public and make their recommendations to District FP&F officers who have guidelines on which cases they may rule on and which they must refer to Customs Headquarters. We would not have performance standards tied to either assessments or collections since the guidelines for each are set by overall national policy and are not within the control of the person handling the case. His or her performance rating should be, and is, based on the handling of cases in conformance with established procedures and established time limits.

6. Question: Shortening Audit Cycles

During your testimony you indicated that it would improve Custom' deterrence efforts if the Service could move from a 25-year audit cycle for large importers to a 5-year cycle. You indicated that there are a variety of audits that could be conducted more frequently, e.g. compliance audits for foreign trade zones and bonded warehouses, fraud audits and national audits. Please provide a description of the makeup of a 5-year audit cycle and how it would differ from current audit activity. Also provide a description of the types of management changes that would be necessary to achieve the 5-year audit cycle. Please include recommended changes to statutory requirements for Customs staff functions, modernization programs that would require statutory authority, additional funding and management changes within Customs current authority.

Response:

Customs Regulatory Audit Program currently selects importers for audit based on several factors, including volume of imports, types of imports, information on potential violations, past experience with the firms, etc. The audits also are a key factor in promoting industry informed compliance. Currently, about 4% of major importers are audited annually.

Customs recently reevaluated its current approach to imposing effective revenue protection and promoting informed compliance. The planned approach focuses on the top 500 importers (representing 53% of the total merchandise imports). These firms would be audited on a 5-year cycle. We believe that the overall trade community will be fully aware of any actions against the top importers, which should greatly assist us in achieving our informed compliance goal. As additional auditors become available, the panel of firms to be audited will be increased and placed on the regular cycle. We believe that the revenue will be protected under this plan since the very largest importers will be audited on a regular basis. Also, we will continue to target importers where specific information surfaces on potential violations.

Customs also is exploring converting the current trade audit into informed compliance audits--essentially using the audits to insure that firms are aware of Customs trade policy and procedures. These audits will be integrated into a comprehensive compliance system that incorporates import specialists and maximizes approaches to augment scarce resources. Compliance snapshots derived from statistical sampling will be introduced to target potential violating firms, industries or geographic areas. The compliance snapshot will maximize resource capability by focussing upon key audit areas.

At this time, Customs does not believe that any statutory changes are required specifically to support its regulatory Audit function. The recently enacted Customs Modernization Act provided the full statutory support required.

7. Question: Restructuring Penalties

During the hearing there appeared to be a general consensus that the current penalties for transshipping textile and apparel products into the United States were not sufficient to deter the activity. Please describe the penalties that are currently in place for the parties that can be involved in transshipping such as exporters, brokers, wholesalers, and retailers, and then suggest revision to those penalties that would provide greater deterrence.

Response:

The penalty provisions of 19 U.S.C. 1592 are applicable to any party who is involved in making material false statements or providing false information to Customs concerning any entry of merchandise. Thus, exporters, importers, wholesalers, retailers, brokers or other parties concerned in the import transaction may be subject to severe monetary penalties under 19 U.S.C. 1592. Also, subject to the limitations of the Customs Modernization Act, the merchandise involved in the transaction may be subject to seizure under 19 U.S.C. 1595a(c) if the merchandise was imported contrary to a Customs law, other than 19 U.S.C. 1592, or a law enforced by the Customs Service. Further, merchandise or conveyances which were utilized for the facilitation of the illegal importation or subsequent transportation of the merchandise may be subject to seizure pursuant to 19 U.S.C. 1592a(a).

Also, any party who in any way was involved in or facilitated the illegal importation may be subject to a monetary penalty under 19 U.S.C. 1595a(b), which is set in the amount of the domestic value of the illegally imported merchandise. If the involved party is a broker, specific monetary penalties under 19 U.S.C. 1641 may also be applicable.

To provide a greater deterrent effect upon the transshipment of textiles, Customs is suggesting revisions to existing regulations in three areas: the period of discovery of a violation involving textiles, the guidelines for determining the severity of a violation involving transshipment and a requirement that importers certify as to the origin of textiles that they are importing. In the first instance, Customs is proposing to extend the period for allowing Customs to issue notices to redeliver the violative merchandise to 180 days. The current 30 day period generally limits Customs to taking such action based on limited information, i.e. that information readily available in the papers relating to the actual import transaction. An extension of this discovery period will extend the time during which Customs can establish the bona fides of an importation and enable Customs to use information collected after the import transaction to establish a violation and to begin the penalty process.

Customs is also proposing to amend the guidelines for 19 U.S.C. 1592 penalties to include textile transshipment as an aggravating factor. Finally, Customs is proposing to require that importers prepare Certificates of Origin for the goods that they are importing. Customs is of the opinion that importers will be somewhat more reluctant to transship goods if they are made to personally certify to the origin of their merchandise. Additionally, such certification, if proven to be false, would be considered in any subsequent penalty action.

8. Question: Enforcement Levels

Recent press accounts indicate Operation Q-Tip has had two separate prosecutions resulting in seven separate convictions. Given that the value of transshipments entering the United States are in the billions of dollars, why are the number of prosecutions so small? What changes in the law would facilitate increased prosecutions? If you expect prosecutions to increase, please indicate when and by how much.

Response:

To date, the U.S. Attorney's office in New York has accepted 34 Operations Q-Tip investigations for prosecution. Of those cases, five companies and 12 individuals have been indicted. There have been 18 arrest warrants issued, of which 11 individuals have been arrested and seven individuals are fugitives. All seven fugitives are currently residing in foreign countries, outside the jurisdiction of the United States Government. In addition, eight criminal information items have been filed. At this time, nine individuals and six companies have been convicted.

Customs has prepared proposed statutory enhancements to our enforcement activities. They are currently under Department of Treasury review. Customs believes that these changes in the law would materially assist our enforcement programs. Once approved by the Department, Customs is available to brief your staff on the proposed legislation.

Customs has no reluctance or reservations to investigating and taking appropriate enforcement action against any importer who attempts to evade or circumvent Customs laws. We are prepared to undertake such investigations and gather the required information. The prosecution decision is under the jurisdiction of the Department of Justice.

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FINANCIAL SYSTEM Core financial systems do not provide complete and accurate information that could be used to prepare Principal Statements.	2	Implement a fully integrated system with appropriate internal control safeguards, cost accounting capabilities and ancillary system interfaces to the general ledger to facilitate the compilation of the financial statements on an accrual basis of accounting. Customs is re-evaluating the timeliness of the financial statements and what enhancements may be implemented sooner to show substantial progress in FY 1994 & 1995.	Revenue System OIM AIMS-CARA Commercial Ops Inspection & Control NFC Regions and Districts	AIMS/CARA - Data gathering & documenta- tion phase (12/93).	Assess & incorporate Moderniza- tion Act. AIMS/CARA - Incorporate current process into Business Design Facilitator System.	Assess & incorporate Moderniza- tion Act. AIMS/CARA - Develop prototype models and begin programming selected modules.	Assess & incorporate Moderniza- tion Act. AIMS/CARA - Programming/ implement any completed modules.	Earliest possible implemen- tation date for fully integrated financial system.
				Special Task Force recom- mendations for Sanction, Manifest, etc	Implement Special Task Force recommenda- tions.	Implement Task Force recommenda- tions.	Implement Task Force recommenda- tions.	
				ACS Steering Committee projects-ex. -Payment Certifica- tion	ACS Financial Core (8/94)	ACS Financial Core complete	FACET - (Based on Conceptual Design Document)	ACS Steering Committee projects.
					FACET - Conceptual Design Document (completed 11/93, and approved 4/94)	FACET - Conceptual Design Document	FACET - Conceptual Design Document	

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INTERNAL CONTROLS System and manual controls over processes are insufficient to ensure the completeness and accuracy of data.	1	Review and strengthen controls over processes and systems as recommended by GAO and other external sources, and as determined by internal reviews conducted by Customs.	Administrative System OIM AIMS NFC Budget Logistics ENS/FMS SACs/District Directors	FFS core accounting system implemented 10/92.	AIMS Phase II project plan items implemented. (Dependant on Department system reviews)	AIMS Phase II project plan items implemented. (Dependant on Department system reviews)	AIMS Phase II project plan items implemented. (Dependant on Department system reviews)	
			Organizational Effectiveness OIM-Comptroller All Organizational & Field Offices		Begin review of entire management control system. Review to duplicate strengths and remaining. Hold managers accountable through more accurate systems and data.	Finish review of management control system. Review to duplicate strengths and remaining. Hold managers accountable through more accurate systems and data.		Earliest possible date for completed manual and systems controls.
				Certain manual controls can be enhanced.	Certain manual controls can be enhanced.	Certain manual controls can be enhanced.	System controls can be enhanced as modifications are made.	

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COMPLIANCE Compliance with applicable laws, rules and regulations.	1	Ensure compliance with applicable laws.	OM-Comptroller All Organiza- tions & Field Offices	GAO reported no material instances of non-conform- ance during FY92 audit.	Assess impact of Moderniza- tion Act.	X	X	X
	1	Ensure compliance with applicable rules and regulations (including generally accepted accounting principles) by holding employee and employee's manager accountable for compliance to procedures, creating a report card to managers providing feedback on their's and their subordinates performance, and implementing automated systems that meet regulatory standards.	All Organiza- tions & Field Offices	Policies & Procedures Maintain current policies and procedures. Continue use of internal management reviews and Red Flag reports.	X	X	X	Soonest possible date to assure compliance of all rules and regulations including generally accepted accounting principals

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FINANCIAL DISCLOSURE Historical experience on seizures was not fully disclosed.				Automated Systems Compliant Core accounting system implemented.	Implement ACS Steering Committee Projects	Implement ACS Steering Committee Projects	Implement ACS Steering Committee Projects	
				AIMS/CARA Project begins.	AIMS/CARA Project	AIMS/CARA Project	AIMS/CARA Project	
				ACS Financial Core available 8/94	ACS Financial Core available 8/94	ACS Financial Core completed		
					FACET - Conceptual Document Approved	FACET - Conceptual Document	FACET - (Based on Conceptual Document)	
					Special Task Force recommendations implemented	Special Task Force recommendations implemented	Special Task Force recommendations implemented	
	2	Enhance systems to monitor the status of seized property and develop needed reports.	Seizure & Penalty Div OIM NFC		FP&F System Redesign implemented 1/94. CPO reports available	FP&F System Redesign operational reports completed		
	1	Analyze available data and develop ad hoc reports.	Seizure & Penalty Div NFC OIM	Completed for FY 1993 statements				

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Disclosure of 28 aircraft on loan from DOD was not made.	1	Appropriate disclosure and liability will be made.	NFC OE-Air Ops	Completed for FY 1993 statements				
Amount of revenue reported as allocated to Dept of Ag was materially misstated.	1	After review of statutes and discussion with Treasury, appropriate disclosure will be determined and presented to GAO for concurrence.	NFC	Completed for FY 1993 statements				
Full disclosure of commitments and contingencies from sales, gifts and Refund and Disback appropriation was not made.	1	Disclosure was appropriate based upon advice from Customs Counsel. Customs and GAO Counsels will review and resolve issue.	Counsel NFC	Completed for FY 1993 statements				
Operating expenses were not reported by budget program.	2	Implement cost accounting system.	AIMS NFC All Organiza- tions & Field Offices	Prototype cost methodology completed for Virgins Islands	Prototype cost metho- dologies completed for Puerto Rico, SE Region & HQ activities.	Completed with Customs-wide implemen- ta- tion		
	2	Implement Project Cost Accounting System (PCAS).	AIMS NFC Budget All Organiza- tions & Field Offices		Implement for project tracking.			
	1	Develop ad hoc routines to determine program costs.	NFC Budget AIMS	Review Budget Div. reports and determine if additional reports can be created (complete for FY 1993 statements).	X			

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Documentation to support all adjusting entries was incomplete.	1	Documentation for all adjusting entries and changes in statement and footnote presentation will be retained.	NFC	Completed for FY 1993 statements.				
FINANCIAL STATEMENTS								
CUSTODIAL ACCOUNTS RECEIVABLE								

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Controls are insufficient to ensure identification of all valid receivables.	2	Currently analyzing data to develop and implement an accounts receivable subsidiary ledger that interfaces with General Ledger.	AIMS/CARA FACET OIM NFC Commercial Ops Regions and Districts	AIMS/CARA Data gathering and document findings (12/93).	Assess & incorporate Modernization Act. AIMS/CARA Incorporate current process into a Business System and review.	Assess & incorporate Modernization Act. AIMS/CARA Develop prototype models. ACS Financial Core completed.	Assess & incorporate Modernization Act. AIMS/CARA Programming.	Earliest possible implementation. Pending completion of system work.
	1	(1) Identify and review all revenue and related transactions, (2) determine proper accounting treatment, and (3) document procedures for recording and reporting.	NFC Regions and Districts	Items (1) & (2) underway for FY 1993 statements.	ACS Financial Core available 8/94. FACET Conceptual Design Document draft 11/93 approved 4/94 Complete items (1), (2) & (3).	FACET (Based on Conceptual Design Document)	FACET (Based on Conceptual Design Document)	

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Unsupportable amounts included in the receivable balance.	1	Develop ad hoc routines to identify population of all valid receivables and information needed to assist in determination of collectibility.	NFC OIM	X	X	X	X	Completed pending implemen- tation of accounts receivable subsidiary ledger.
	1	Selected receivables will be evaluated to determine the validity of the outstanding receivable to supporting documentation.	NFC Commercial Ops Regions and Districts	X	X	X	X	
	1	Accounts Receivable Section will continue to review supporting documentation of segmental duty, miscellaneous and reimbursable receivables.	NFC Regions and Districts	X	X	X	X	X
	2	Accounts Receivable Section will expand their processing to cover all receivables types.	NFC Regions and Districts	-	-	X	X	X
	1	Instruct managers to retain supporting documentation until receivable is liquidated, i.e. entry, bond, etc..	NFC Regions and Districts	Managers instructed. Receivables tested to ensure documen- tation supports liquidity by Districts and NFC.	Testing of imaging software. Control question- naires to address liquidity feedback to District and regional managers.	X	X	X

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Collectibility methodology was unreliable as it did not include an analysis of pay. Assessments with the debtor's ability to pay. Assessments did not identify sub-groups with similar collection risk characteristics.	1	Develop methodology for determining reliable collectibility amounts and obtain GAO concurrence.	NFC	Completed for FY 1993 statements.	Assess & incorporate Modernization Act.	Assess & incorporate Modernization Act.	Assess & incorporate Modernization Act.	Assess & incorporate Modernization Act.
	2	Implement accounts receivable subsidiary ledger that interfaces with General Ledger.	AIMS/CARA FACET OIM NFC Commercial Ops Regions and Districts	AIMS/CARA - Data gathering & documentation phase (12/93).	AIMS/CARA - Load process into a Business Design Facilitator System. ACS Financial Core (8/94).	AIMS/CARA - Develop prototype model/begin programming selected modules. ACS Financial Core completed.	AIMS/CARA - Programming/Implement any completed modules. FACET - (Based on Conceptual Design Document)	Earliest possible implementation of integrated system.
	1	Develop ad hoc routines to identify populations and information needed to assist in analysis.	NFC OIM	Completed for FY 1993 statements.	FACET - Conceptual Design Document approved 4/94	FACET - (Based on Conceptual Design Document)	X	Completed pending implementation of accounts receivable subsidiary ledger with needed reports.

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Detailed receivable records are not routinely reconciled or updated in a timely manner, particularly penalties, fines and assessments.	2	Develop ad hoc routines to identify a statistical sample for evaluation of outstanding receivable amounts to determine collectibility, and obtain contractor assistance.	NFC OTM	Customs/GAO coordinating effort to identify statistical samples using GAO's PC software.	Incorporate statistical methodology from FY 1993 into report requirements	X	X	
		Implement a fully integrated accounts receivable subsidiary ledger to compile all transactions related to a debtors account.	AIMS/CARA FACET OTM NFC Commercial Ops Regions and Districts	AIMS/CARA - Data gathering & documentation phase (12/93).	Assess & incorporate Modernization Act. AIMS/CARA - Incorporate current process into a business design. Implement Facet Indicator System.	Assess & incorporate Modernization Act. AIMS/CARA - Develop prototype models and begin programming selected modules.	Assess & incorporate Modernization Act. AIMS/CARA - Programming/Implement any completed modules.	Earliest possible implementation of a fully integrated accounts receivable system.
				ACS Financial Core available 8/94	ACS Financial Core available 8/94	ACS Financial Core completed.	FACET - (Based on Conceptual Design Document)	FACET - (Based on Conceptual Design Document)
				FACET - Conceptual Design Document (completed 11/93 and approved 4/94)				

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Final determination of Customs duty owed (entry summary liquidation process) is not timely. Processing one year after release of merchandise.	2	Implement interim system enhancements and procedures.	NFC AIMS/CARA OIM All Organiza- tions & Field Offices	-	FP&F Redesign (1/94) NFC Accounts Receivable Section PC- based system enhancements (12/93).	CARA/FACET possible short-term enhancements identified through data gathering.	X	Completed pending implemen- tation of receivable subsidiary ledger.
	1	Develop ad hoc reports and manual procedures to reconcile and update detailed accounts receivable records.	NFC OIM Regions and Districts	*NFC Accounts Receivable Section procedures relating to supplemental duty, misc., and reimbur- sable bills.	Update NFC Accounts Receivable Section procedures relating to PC-based system enhancement. Implement procedures to review detailed receivable records not reviewed by the NFC.	Expand NFC Accounts Receivable Section procedures to cover all receivable types.	X	Completed pending implemen- tation of receivable subsidiary ledger.
	1	Instruct managers to follow established procedures to determine Customs duties.	NFC Regions and Districts	Managers instructed.	X	X	X	X
	2	Provide current 'Red Flag' report in an on-line environment for more timely and wider distribution to managers.	OIM Regions and Districts	Demonstra- tion of on- line 'Red Flag' reports.	Completed. User Guide describes impact on CFO.			

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Controls assuring bonding sufficiency are lacking.	2	Develop and implement a bond module to compile the data.	OM FACET AIMS/CARA Commercial Ops OIM Regions and Districts	-	Results of OM Task Force for centralizing bonds/determining bond sufficiency. FACET - (Based on Conceptual Design Document approved (4/94).	Possible Bond Sufficiency Module pilot program. FACET - (Based on Conceptual Design Document section addressing bonds)	X	Earliest implementation for integrated bond module/ accounts receivable system.
		Include bond information in the receivable subsidiary ledger.	AIMS/CARA FACET NPC OIM Regions and Districts	-	AIMS/CARA - Data gathering & documentation. FACET - Conceptual Design Document approved 4/94	AIMS/CARA - Develop prototype model/begin programming. FACET - (based on Conceptual Design Document approved)	X	
Protested supplemental duty bills are not processed timely.	1	Instruct managers to follow established procedures and process supplemental duty bills in a timely manner and utilize the 'Red Flag' report that monitors District activity to ensure Districts remain within acceptable tolerances.	Commercial Ops Regions and Districts	Complete prior to statement preparation.	X	X	X	X

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Fine and penalty receivables were recorded at a net collectibility amount and did not include the entire valid receivable population.	1	Develop methodology for identifying gross and net fines and penalty receivable amounts and obtain GAO concurrence.	NFC	Complete for FY 1993 statements.				
	2	Redesign of the current FP&F Module, including a post-conversion review of existing records to confirm validity, and development of required reports.	Fines/Penalty Division FP&F Offices OIM NFC	-	FP&F system redesign implemented 1/94; CFO reports by 9/30/94).	FP&F operations reports completed.		
	1	Develop ad hoc report routines and evaluate data to determine complete population and gross and net receivable amount.	NFC Fines/Penalty Division OIM	Complete for FY 1993 statements.	X			
Control over documents needed to support and collect balances due are lacking.	1	Instruct managers to retain and maintain all supporting documentation until amounts owed are collected.	OM Commercial Ops Regions and Districts	Managers instructed.	Field testing of Imaging Software. Internal Control questionnaires to address issues specifically with feedback to District and Regional managers.	X	X	X

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Financial management systems do not provide current and accurate information on the status of receivables.	2	Implement an accounts receivable subsidiary ledger system that interfaces with the General Ledger.	AIMS/CARA FACET OIM NFC Commercial Ops Field Offices	AIMS/CARA - Data gathering & documentation phase (12/93).	Assess & incorporate Modernization Act. AIMS/CARA - Incorporate current process into a Business Design Facilitator System. ACS Financial core available 8/94 FACET - Conceptual Design Document approved 4/94	Assess & incorporate Modernization Act. AIMS/CARA - Develop prototype model and begin programming. ACS Financial Core completed FACET - (Based on Conceptual Design Document)	Assess & incorporate Modernization Act. AIMS/CARA - Complete programming. FACET - (Based on Conceptual Design Document)	Earliest possible implementation of integrated system.
	2	Develop short-term enhancements to the current accounts receivable PC based system and implement new PP&F Module.	NFC OIM	-	Completed (PC enhancements for supplemental duty, misc. reimbursables receivables 12/93; PP&F 1/94).	Additional short-term enhancements may be added based upon AIMS/CARA data gathering or NFC needs.	X	Completed pending implementation of receivable subsidiary ledger.
	1	Develop ad hoc report routines.	NFC OIM	Complete for FY 1993 Statements.	X	X	X	

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Collection efforts are hampered in part due to failure to sanction delinquent importers.	2	Re-evaluate sanction policy and procedures.	OM Commercial Ops FACET	OM Sanction Task Force.	Implement interim manual procedures to ensure sanctions are applied uniformly.	X	X	Incorporate into receivable subsidiary ledger processes.
	1	Revise methodology and provide to GAO for concurrence.	NFC OIM	Complete for FY 1993 statements.				
	2	Implement a receivable subsidiary ledger that interfaces with the ACS Entry Module and General Ledger.	AIMS/CARA FACET OIM NFC Commercial Ops Systems and Districts	AIMS/CARA - Data gathering & documenta- tion phase.	Assess & incorporate Moderniza- tion Act. AIMS/CARA - incorporate current process into Business Design Facilitator System. ACS Financial Core available 8/94 FACET - Conceptual Design Document (completed 11/93 and approved 4/94)	Assess & incorporate Moderniza- tion Act. AIMS/CARA - Develop prototype models and begin programming. ACS Financial Core completed. FACET - (Based on Conceptual Design Document)	X	Earliest possible implementation of fully integrated system.

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Codes are not always used to establish deferred tax/credit card receivables.	1	Develop ad hoc routines to identify population and determine accrual amount.	NFC OIM	Completed prior to FY 1993 statement preparation.	X	X	X	
	1	Remind managers of established procedures.	NFC	Completed prior to FY 1993 statement preparation.	X	X	X	X
	2	Review and revise as needed system edits.	AIMS OIM	Data gathering and documentation effort.	Incorporate into CAA schedule.	X	X	Completed with implementation of integrated receivable subsidiary ledger.
	1	Develop ad hoc routines to identify unpaid amounts with no corresponding receivables and inform District Directors of findings.	NFC OIM District Directors	Complete for FY 1993 statements.	X	Completed pending implementation of short-term modification		
SEIZED PROPERTY Records to control, manage, and report seized property were incomplete, inaccurate with respect to physical location, valuation, and status, and included in transactions recorded in the wrong period.	2	Implement redesign to seizure tracking systems.	Seizure & Penalty Div OIM	-	Completed (1/94)			
	1	Perform physical inventory of seized property and compare to system and manual records to ensure validity and accuracy.	Seizure & Penalty Div District PP&F NFC	Physical inventory of high risk items (OVI, firearms & ammunition) for FY 1993 statements.	Perform 100% seized inventory. Update case files and automated systems with results.	X	X	X

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Established procedures are not always followed. Procedures are always applied to safeguarding and assuring proper accountability of seized property.	1	Managers will be instructed to retain supporting values recorded in the property and accounting systems. Compliance to be monitored.	Seizure & Inventory Div Field Offices Commercial Ops NFC	Complete prior to start of construction. Warehouse security upgrades/new facilities under construction.	X	X	X	X
		Procedures to be reviewed and updated as necessary.		-	Procedures to be reviewed and updated as necessary and review started.	Review and update of procedures completed.	X	X
PROPERTY Valuation was based on unreliable property and accounting records, and unrealistic estimates.	1	Instruct Managers to retain documents supporting values recorded in the property and accounting systems.	MLC NFC Organization Field Offices	Managers instructed.	Internal control questionnaires addressed to address specifically with feedback to managers.	X	X	X
		Develop methodology to support values obtained via other than normal procurement methods and obtain GAO concurrence.	MLC NFC	Methodology developed and applied for largest group items prior to procurement preparation.	Completed.			

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Assets were not safeguarded against theft or misappropriation.	1 ✓	Managers will be instructed to follow established procedures for recording property activity.	NLC All Organiza- tions & Field Offices	Managers instructed. QA visits to continue at high risk locations.	X	X	X	X
Reconciliation of accounting records and related property subsidiary records was not performed to ensure all property items were accounted for and properly valued.	1 ✓	Reconcile accounting and related property records. Property valuation will be reviewed to ensure property records are recorded in the property and general ledger systems.	NPC NLC All Organiza- tions & Field Offices	Complete prior to statement preparation.	X	X	X	X
Physical inventory of non-equipment items not performed (i.e., Real Property).	2 ✓	Develop procedures, obtain GAO concurrence, and perform physical inventory of non-equipment items.	NLC All Organiza- tions & Field Offices	Review of largest group of non-equipment locations in PIMS partially completed prior to statement preparation.	Completed.	X	X	X
Ineffective physical inventories were performed on equipment.	1 ✓	Modify procedures for performing equipment item physical inventory and provide to GAO for concurrence. Implement procedures.	NLC	Method for existing equipment to be applied prior to statement preparation. Completed (7/93)	Develop procedures existing and perform annual physical inventory.	X	X	X
			NLC All Organiza- tions & Field Offices	Complete for FY 1993 statements.	X	X	X	X

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Property records did not include amounts for in-house developed software.	2 ✓	Develop methodology for capturing costs to include in general ledger.	NLC NFC	Accounting records to be reviewed prior to statement preparation.	Methodology prepared and implemented to capture costs.			
REVENUE								
Internal controls do not ensure merchandise entering the country is identified and the proper duty assessed.	2	Evaluate/adjust controls to ensure proper duties are assessed, improve importer compliance, and target inspections for trade enforcement purposes.	Various Task Forces	Data gathering and project implementation.	Conceptual document and schedule of implementation/implementation.	Implement recommendations based on Conceptual Document.	X	X

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No assurance can be given that Customs can identify all revenues that should have been collected during any accounting period.	1	Modify laws and regulations, such as the Customs Modernization Act.	Commercial Ops	Contingent upon passage of law/ amendments to regulations.	Assess Impact of Modernization Act. Contingent upon passage of law/ amendments to regulations.	X	X	X
DRAWBACKS								

U. S. CUSTOMS SERVICE
COMPREHENSIVE PLAN FOR FINANCIAL MANAGEMENT IMPROVEMENT
CHIEF FINANCIAL OFFICERS ACT PROJECT

ISSUE	PRIORITY FOR FY 93	CORRECTIVE ACTION	RESPONSIBLE OFFICE	FY 1993	FY 1994	FY 1995	FY 1996	FY 1997
Controls over drawback claims and payments are inadequate.	1	Study and evaluate internal controls over drawback process.	Commercial Ops AIMS/CARA FACET	AIMS/CARA - Data gathering and document procedures (12/93).	Assess & implement separate Modernization Act. QA reviews implemented. AIMS/CARA - Develop/implement short-term financial enhancements if possible.	X	X	Earliest implementation of integrated system.
	2	Redesign the Drawback Module of ACS implementing enhancements as completed.	FACET AIMS/CARA Commercial Ops OIM		FACET - Conceptual Design Document approved 4/94 Implement Payment Certification System enhancement (includes Drawbacks)			
	2	Develop fully integrated system to address control weaknesses.	FACET AIMS/CARA OIM Commercial Ops Regions and Districts NFC	-	FACET - Conceptual Design Document approved 4/94	FACET - (Based on Conceptual Design Document)	X	

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ISSUE	PRIORITY FOR FY 93	CORRECTIVE ACTION	RESPONSIBLE OFFICE	FY 1993	FY 1994	FY 1995	FY 1996	FY 1997
	2	Enhance manual procedures to enhance controls.	NFC Regions and Districts	-	Enhance manual controls to ensure claim is accurate, bond is adequate, accelerated payment received by authorized claimants, etc.	X	X	Completed pending implementation of system controls based on FACET/CARA efforts.
ACCOUNTS PAYABLE Financial systems do not record liability until an invoice is received and processed.	2	Establish accounts payable at time receipt of goods/services is recorded by expanding document types processed through CIAS and ARRS.	AIMS Phase II NFC Procurement Logistics Mgmt OIM	On hold during Department system review and analysis.	X	X	X	X
	2	Develop interim procedures for obtaining receiving reports for non-ARRS documents at time of receipt so unliquidated obligation amounts can be adjusted more timely.	NFC Procurement All Organizations and Field Offices	-	Completed.	X	X	X
	1	Develop ad hoc reports and modify year-end procedures to manually identify year-end liability.	NFC AIMS OIM	Complete for FY 1993 financial statements.	X	X	X	X
Methodology for recording payable may have resulted in overstatement of liability.	1	Require input of goods/service receipt date in FFS during technician invoice processing.	NFC AIMS	Complete for FY 1993 financial statements.				

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ISSUE	PRIORITY FOR FY 93	CORRECTIVE ACTION	RESPONSIBLE OFFICE	FY 1993	FY 1994	FY 1995	FY 1996	FY 1997
Monitoring controls over contracts are weak. The receipt of goods/services is not always confirmed prior to issuing a receiving report.	1	Instruct Managers to verify and document receipt of goods/services before payment is authorized.	NFC AIMS OIM	Complete for FY 1993 financial statements.	X	X	X	X
Information could not be provided to test whether all payables had been identified.	1	Ad hoc report routines will be modified to ensure the identification of all payables can be identified.	NFC AIMS OIM	Complete prior to statement presentation	X	X	X	X
INTRAGOVERNMENTAL RECEIVABLES/REIMBURSABLE SERVICES RETAINED								
Procedures are not followed for recording interagency agreements.	1	Revise procedures, instruct managers to follow procedures and monitor for compliance.	NFC Budget All Organiza- tions & Field Offices	Procedures revised and implemented.	Modify procedures to include posting to additional budgetary account.	X	X	X
Records to support amounts reimbursed by other agencies are not maintained.	2	Incorporate PC based system into general ledger accounting system.	AIMS OIM	-	Project Cost Accounting System implemented.			
	1	Utilize PC based system to track reimbursable agreement activity and retain supporting documentation verifying amounts reimbursed by other agencies.	NFC All Organiza- tions & Field Offices	Completed. PC system implemented. Supporting documentation retained.				

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ISSUE	PRIORITY FOR FY 93	CORRECTIVE ACTION	RESPONSIBLE OFFICE	FY 1993	FY 1994	FY 1995	FY 1996	FY 1997
Available budgetary resources are not properly recorded and reported relating to interagency agreements.	1	Reconcile PC based system to related General Ledger budgetary accounts.	NFC	Completed prior to statement preparation.	Modify procedures to include posting to additional budgetary account.			
Reported balance for reimbursable services and time and materials likely to be understated due to O&M adjustment.	1	Identify, if possible, the appropriate amounts and detail document records for each fiscal year and restate FY 1992 statement.	NFC	Completed prior to statement preparation, if possible.				
UNLIQUIDATED OBLIGATIONS								
Obligation balances are not reduced for the cost of goods and services received.	2	Modify CLAS and ARRS to process all documents and modify ARRS/FFS Interface to automatically reduce unliquidated obligations at time goods and services are received. Develop interim procedures for obtaining receiving reports from ARRS. All Organiza-tions & Field Offices	AIMS Phase II NFC Procurement Logistics All Organiza-tions & Field Offices	-	Pending completion of Department study of bureau systems.	X	X	X
			Procurement All Organiza-tions & Field Offices	-	Completed.			
Unneeded obligations are not debited in a timely manner.	1	Instruct Managers to follow established procedures and review unliquidated obligation balances.	NFC	Completed for FY 1993 statements.	Address in internal control system- managers with feedback to managers.	X	X	X

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ISSUE	PRIORITY FOR FY 93	CORRECTIVE ACTION	RESPONSIBLE OFFICE	FY 1993	FY 1994	FY 1995	FY 1996	FY 1997
Obligations are often misclassified in the accounting records.	1	Instruct Managers and budget officials to follow existing procedures and ensure requisition/obligation documents contain appropriate codes for proper classification.	NFC Budget All Organiza- tions & Field Offices	Completed for FY 1993 statements.	Address in internal control question- naires with feedback to managers.	X	X	X
Documentation could not be provided to support test sample obligations.	1	Instruct Managers to maintain obligation documentation until obligation is fully liquidated.	NFC All Organiza- tions & Field Offices	Completed prior to statement preparation.	Address in internal control question- naires with feedback to managers.	X	X	X
FMEIA Overall severity of internal control and accounting weaknesses were not disclosed in the FMEIA Report. Material weaknesses reported as corrected still exist because it was not determined if the corrective action was effective.	1	Disclose all such weaknesses in the FMEIA report. Monitor weaknesses felt to be resolved to ensure corrective action is effective.	Comptroller	Create an independent high-level group to evaluate the materiality of items for FMEIA Report to treasury.	X	X	X	X
SPECIAL OPERATIONS Controls over funds advanced to agents for special operations and the related documentation are not adequate.	1	Review and modify procedures relating to accountability of advanced funds and supporting documentation.	OE NFC	Partially completed prior to statement preparation.	Completed prior to statement preparation.			

CYCLE AREA: ACCOUNTS RECEIVABLE

Significant improvements (suggested areas as listed in GAO letter dated January 5, 1994):

1. Develop clear and detailed definitions of various accounts receivable and identify means for segregating valid from invalid receivables--Customs has devised a means to do this and is currently testing the process for fines and penalties, supplemental duties, and deferred taxes, however, results are not yet known.
2. Develop a strategy for identifying all receivables that are valid and outstanding--"10 day accrual" should include all valid 3461 releases where payment has not been made, ensure that all valid receivables that were referred to Department of Justice are recorded, ensure that no receivables are recorded twice, verify completeness of carrier reporting on user fees--GAO has provided input on what is required to correct these problems, however, efforts to date have not been satisfactory.
3. Develop procedures and systems routines that will capture accounts receivable activity for 1994--we do not believe Customs has the systems capabilities nor the time necessary to try to identify and correct 1993 activity.
4. Customs has developed a methodology for assessing collectibility that we think is adequate, if properly implemented.
5. We think disclosure of the assessment process through resolution is critical to understanding Customs effectiveness for ensuring compliance with trade laws and provides insight to Customs effectiveness in collecting outstanding amounts, however, similar to item 3 procedures need to be developed and deployed to ensure the entire process is captured and reported. It is imperative that this be part of the systems redesign and in the interim routine procedures should be identified to do this.
6. Customs has implemented new debt collection procedures and we will be briefed on them January 12, 1994. We will review these procedures as part of our audit to assess

whether they adequately address the problems identified last year or any found in the current year audit.

7. The mitigation process is being reviewed in greater depth than last year to better understand the reasons for the wide fluctuation in amounts initially assessed and those ultimately collected. This work has potential implications to financial statement disclosures as well as reported performance. We currently are not sure what the outcome of this work will be but Customs could study the reasonableness of this process to identify what changes are needed.

Impact on GAO reporting (as stated in January letter):

Disclaimer on 1993 receivables activity, however, ending balance in accounts receivable could be given an unqualified opinion if Customs is successful in executing its plans in accounts receivable, which would establish a good beginning balance for 1994. Also, our report on internal controls would discuss the problems for 1993 but highlight the substantive improvements already accomplished and those planned to ensure the 1994 activity is properly captured. Also, internal controls or legislative problems identified as part of our review of the mitigation process, surety bonds, and collection activities will also be discussed.

CYCLE AREA: ACCOUNTS RECEIVABLE
IMPROVEMENT BEING ADDRESSED: #1

Suggested Significant Improvement: Develop clear and detailed definitions of various accounts receivable and identify means for segregating valid from invalid receivables.

Customs Response: Definitions and methodology have been developed for identifying all receivables including validity and collectibility. Statistical samples were developed to review selected receivables by category including 10 day accruals that would be representative of the universe to assure the validity and collectibility of all the receivables. The General Accounting Office has reviewed and concurred in this effort.

Specific Action to Accomplish Task: Field offices identified as possible test locations should be prepared to perform follow up work on selected files.

Action Offices: Assistant and Regional Commissioners
National Finance Center

Key Target Date: On-going

Responsible Official: National Finance Center/Diaforli

CYCLE AREA: ACCOUNTS RECEIVABLE
IMPROVEMENT BEING ADDRESSED: #2

Suggested Significant Improvement: Develop a strategy for identifying all receivables that are valid and outstanding - ensure that "10 day accrual" includes all valid 3461 releases where payment has not been made, that all valid receivables referred to Department of Justice are recorded, that no receivables are recorded twice, and verify completeness of carrier reporting on user fees.

Customs Response: Definitions and methodology have been developed for identifying all receivables including validity and collectibility. Statistical samples were developed to review selected receivables by category including 10 accruals that would be representative of the universe to assure the validity and collectibility of all the receivables. The General Accounting Office has reviewed and concurred in this effort.

Specific Action to Accomplish Task: Completed

Action Office: National Finance Center

Responsible Official: National Finance Center/Diaforli

CYCLE AREA: ACCOUNTS RECEIVABLE
IMPROVEMENT BEING ADDRESSED: #3

Suggested Significant Improvement: Develop procedures and systems routines that will capture accounts receivable activity for 1994.

Customs Response: Customs does not currently have an automated program available to accomplish this for FY 1993. Customs plans to develop such procedures and routines for 1994 activity.

Specific Action to Accomplish Task:

Preliminary planning and development

Action Offices: Office of Information Management
and National Finance Center

Key Target Date: April 1994

Program the system

Action Offices: Office of Information Management
Key Target Date: June 1994

Test the system

Action Office: Office of Information Management
and National Finance Center

Key Target Date: July 1994

Capture accounts receivable information for 1994 activity

Action Office: National Finance Center

Key Target Date: September/October 1994

Responsible Official: National Finance Center/Diaforli
Office of Information Management/Riley

CYCLE AREA: ACCOUNTS RECEIVABLE
IMPROVEMENT BEING ADDRESSED: #4

Suggested Significant Improvement: Develop a methodology for assessing collectibility.

Customs Response: Methodology has been developed and approved by the General Accounting Office. Test of selected transactions ongoing and being monitored by the General Accounting Office.

Specific Action to Accomplish Task: Test selected transactions

Action Office: National Finance Center

Key Target Dates: February 1994

Responsible Official: National Finance Center/Diaforli

**CYCLE AREA: ACCOUNTS RECEIVABLE
SIGNIFICANT IMPROVEMENT BEING ADDRESSED: #5A**

Suggested Significant Improvement: Develop and implement procedures to capture and report the disclosure of the assessment process through resolution for the purpose of ensuring compliance with trade laws and providing insight into Customs effectiveness in collecting outstanding amounts.

Customs Response: In FY 1993 Customs will not be able to disclose figures relating to the amount of assessments and related collections for the various types of receivables collected by Customs. However, Customs will explain in the financial statements footnotes the process of what was assessed and collected in total for 1993. In FY 1994, Customs plans to determine a method to compile the data from the FP&F system and ACS that will show by receivable category the beginning balance, increases from assessments, impact of Customs decision on such assessments and the valid claims billed.

Specific Action to accomplish Task:

Prepare FY 1993 financial statements with aggregate amounts and appropriate footnotes describing the assessment process and capturing the total receivables assessment and collection.

Action Office: National Finance Center
Key Target Dates: March 1994

CFO accountants to meet with ACS and FP&F Programmers, to discuss ad hoc interim requirements and determine feasibility of providing the detailed receivable information for FY 1994 statements.

Action Office: National Finance Center and Office of Information Management
Key Target Dates: April 1994

Program and test reports

Action Office: National Finance Center and Office of Information Management
Target Dates: To Be Determined

Prepare FY 1994 financial statements with information to show disposition of the various receivables assessed by Customs to comply with various trade laws

Action Office: National Finance Center
Key Target Dates: December 1994

Program and test system modifications (incorporate into CARA, FACET, FP&F, as appropriate)

Action Office: National Finance Center and Office of Information Management
Key Target Dates: FY 1995

Responsible Official: National Finance Center/Diaforli
Office of Information Management/Riley

CYCLE AREA: ACCOUNTS RECEIVABLE
SIGNIFICANT IMPROVEMENT BEING ADDRESSED: #5B

Suggested Significant Improvement: Develop and implement interim procedures to capture and report the disclosure of the assessment process through resolution until such time as the systems redesign.

Customs Response: Interim procedures have been developed to explain and disclose the assessment and collection process and the related aggregate amounts for FY 1993. For Fiscal Year 1994 ad hoc reports will be designed where feasible to compile by receivable categories the assessed and collected figures.

Specific Action to Accomplish Task:

Develop procedures for 1993 statements

Action Office: National Finance Center

Key Target Date: February 1994

Develop ad hoc reports

Action Office: National Finance Center and Office of Information Management

Key Target Date: April 1994

Prepare ad hoc reports used to compile the required data

Action Office: National Finance Center

Key Target Date: September 1994

Responsible officials: National Finance Center/Diaforli
 Office of Information Management/Riley

CYCLE AREA: ACCOUNTS RECEIVABLE
IMPROVEMENT BEING ADDRESSED: #6

Suggested Significant Improvement: Develop and implement new debt collection procedures.

Customs Response: Debt collection procedures were developed and a separate unit was established to collect delinquent debts for supplemental duty bills and miscellaneous reimbursable bills. General Accounting Office was briefed on the unit's operations and stated Customs was on the "right track" and agreed that Customs should expand the unit's responsibility to include all delinquent receivables.

Specific Action to Accomplish Task: Completed.

Action Office: National Finance Center

Responsible Official: National Finance Center/Diaforli

**CYCLE AREA: ACCOUNTS RECEIVABLE
IMPROVEMENT BEING ADDRESSED: #7**

Suggested Significant Improvement: The mitigation process is being reviewed in greater depth than last year to better understand the reasons for the wide fluctuation in amounts initially assessed and those ultimately collected. This work has potential implications to financial statement disclosures as well as reported performance. We currently are not sure what the outcome of this work will be but customs could study the reasonableness of this process to identify what changes are needed.

Customs Response: Customs will brief General Accounting Office personnel on the mitigation process for purposes of providing background prior to their indepth review into the wide fluctuation in amount initially assessed and those ultimately collected.

Specific Action to Accomplish Task: Schedule and conduct briefing

Action Office: Office of Commercial Operations

Key Target Date: February 1994

Responsible Official: Office of Commercial Operations/Hiatt

CYCLE AREA: SEIZED PROPERTY

Significant improvements (suggested areas as listed in GAO letter dated January 5, 1994):

1. Perform a 100% inventory of seized property quantities as soon as possible with procedures to "roll this inventory back" to 9/30/93, in order to establish a valid opening balance for fiscal year 1994. In addition, procedures should be performed to establish accurate valuation of the seized assets in the ending inventory. Most of the information needed to effectively perform such procedures can be located in the individual case files. Further, cut-off procedures should be executed to ensure transactions are recorded when they occur.
2. Procedures should be established to ensure that all seizure activity for fiscal year 1994 is properly recorded in CPTS. If this cannot currently be achieved using CPTS, then alternative procedures should be developed to accurately and completely accumulate and report this information until such time that the CPTS redesign is implemented.
3. Upgrade existing storage facilities or construct new ones to improve the physical safeguarding of seized property. Also, a Customs wide policy should be established requiring at least two Customs officers to be present when accessing seized property in district vaults.

Impact on GAO reporting (as stated in January letter):

Disclaimer on 1993 seized property activity reported because Customs could not provide detailed support for 1993 activity. It is possible for an unqualified opinion on September 30, 1993, seized property balances if physical inventory, rollback, valuation, and cutoff is properly performed. Report internal control weaknesses found in 1993 and highlight efforts in fiscal year 1994 to address these problems.

**CYCLE AREA: SEIZED PROPERTY
IMPROVEMENT BEING ADDRESSED: #1A**

Suggested Significant Improvement: Perform a 100% inventory of seized property quantities as soon as possible with procedures to "roll this inventory back" to 9/30/93 in order to establish a valid opening balance for fiscal year 1994, and to test and weigh narcotics.

Customs Response: Customs has performed a 100% "test" inventory of seized currency and weapons, during the month of November 1993. A 100% inventory for all seized property quantities will be performed starting February 15, 1994, assuming that the Customs inventory procedures are approved by GAO by February 7. This inventory will be fully coordinated with GAO to ensure compliance with audit standards and in an attempt to develop adequate procedures to "roll this inventory back" to 9/30/93. Draft inventory procedures were submitted to GAO on February 2.

Specific Actions To Accomplish Task:

Reconciliation of automated and manual seizure records must be conducted by all Seized Property Custodians and Specialists (SPC/S) and FP&F Officers. Assistance in reviewing all open FP&F case files will be requested from other operational offices (i.e.; Inspection & Control) as necessary.

Action Office: Assistant and Regional Commissioners
Key Target Dates: January 25 - February 11, 1994

Discussions to develop procedures to "roll back this inventory" will continue with GAO, a final decision on the creation of a "roll back" needs to be developed.

Action Office: Office of Commercial Operations
Key Target Date: February 25, 1994

Procedures for taking an inventory of seized assets must be developed and properly executed

Action Office: Office of Commercial Operations
Key Target Dates: February 7, 1994

Train cadre of inventory reviewers

Action Office: Office of Commercial Operations
Key Target Dates: February 7 - 11, 1994

Develop, run and test automated inventory reports

Action Office: Office of Commercial Operations and
Office of Information Management
Key Target Dates: February 2 - 14, 1994

Conduct inventory of seized assets

Action Office: Regional Commissioners
Key Target Dates: February 15 - 25, 1994

Evaluate and Monitor inventory

Action Office: Office of Commercial Operations
Key Target Dates: February 15 - 25, 1994

Reconcile inventory findings and "roll back inventory", if

possible, to establish opening balance as of 9/30/93.

Action Office: Office of Commercial Operations

Key Target Dates: February 28 - March 11, 1994

Establish balance for financial statement presentation and submit to NFC for inclusion in Financial Statements.

Action Office: Office of Commercial Operations

Key Target Date: March 15, 1994

Responsible Official: Seizures & Penalties Division/Bartoldus

**CYCLE AREA: SEIZED PROPERTY
IMPROVEMENT BEING ADDRESSED: #1B**

Suggested Significant Improvement: Establish and perform procedures to establish accurate valuation of the seized assets in ending inventory. (see #1A).

Customs Response: Customs will conduct a manual review of all open seizure case files to ensure that accurate valuation of seized assets is reflected in our automated systems (CPTS and SCTS). This will be a primary focus of our reconciliation of automated and manual seizure records. Test procedures will be included in our seized asset inventory to ensure compliance with existing Customs policy. Policies, procedures and automated systems will be updated whenever found to be inadequate.

Specific Action To Accomplish Task:

Reconciliation of automated and manual seizure records must be conducted by all Seized Property Custodians and Specialists (SPC/S) and FP&F Officers

Action Office: Regional Commissioners

Key Target Dates: January 25 - February 11, 1994

Develop, run and test automated inventory reports

Action Office: Office of Commercial Operations and
Office of Information Management

Key Target Dates: February 2 - 28, 1994

Conduct review of inventory findings and update valuation procedures wherever applicable

Action Office: Office of Commercial Operations

Key Target Dates: April 4 - 29, 1994

Implement procedures for end of the year inventory to include accurate valuation of all seized property quantities.

Action Office: Office of Commercial Operations

Key Target Dates: September 30, 1994

Conduct end of the year inventory for FY '94

Action Office: Regional Commissioners

Key Target Dates: September 30, 1994

Responsible Official: Seizures & Penalties Division/Bartoldus

**CYCLE AREA: SEIZED PROPERTY
IMPROVEMENT BEING ADDRESSED: #1C**

Suggested Significant Improvement: Execute cut-off procedures to ensure transactions are recorded when they occur. (See #1A)

Customs Response: As part of Customs inventory procedures, a reconciliation of all manual and automated records will be conducted. These procedures will include a cut-off procedure to ensure transactions are recorded when they occur. (See 1a -b) Customs will also utilize the February through March inventory to establish improved procedures for our FY 1994 end of the year inventory.

Specific Action To Accomplish Task:

Establish cut-off procedure as part of Customs inventory plans for seized and forfeited assets.

Action Office: Office of Commercial Operations

Key Target Date: February 11, 1994

Reconciliation of all automated and manual seizure records, including cut-off procedure

Action Office: Regional Commissioners

Key Target Date: January 25 - February 11, 1994

Develop, run and test automated inventory reports

Action Office: Office of Commercial Operations

Key Target Dates: February 2 - 28, 1994

Conduct inventory of seized assets

Action Office: Regional Commissioners

Key Target Dates: February 15 - 25, 1994

Evaluate and monitor inventory

Action Office: Office of Commercial Operations

Key Target Dates: February 15 - 25, 1994

Conduct review of inventory findings and update cut-off procedure as applicable

Action Office: Office of Commercial Operations

Key Target Dates: September 1, 1994

Implement procedures for end of the year inventory to include updated cut-off procedures

Action Office: Office of Commercial Operations

Key Target Dates: September 30, 1994

Conduct end of the year inventory for FY '94

Action Offices: Regional Commissioners

Key Target Dates: September 30, 1994

Responsible Official: Seizures & Penalties Division/Bartoldus

**CYCLE AREA: SEIZED PROPERTY
IMPROVEMENT BEING ADDRESSED: #2A**

Suggested Significant Improvement: Establish procedures to ensure that all seizure activity for fiscal year 1994 is properly recorded in CPTS.

Customs Response: The Customs Property Tracking System (CPTS) and the Seized Currency Tracking System (SCTS) are currently undergoing extensive programming redesign to ensure accuracy of our automated seizure records. These two systems and all FP&F case processing will be combined into a single new system called the Seized Property and Currency Tracking System (SPCTS), which should be implemented before the end of FY 1994.

The design for SPCTS includes the automatic update of seizure records to include all seizure activity. The specific discrepancy illustrated by GAO refers to CPTS's inability to automatically capture revised seizure information once the original seizure line items have been locked into CPTS. Line item data is locked into CPTS as part of the automated interface between TECS II - SAS records and CPTS. Once an SAS record is approved, it is downloaded into CPTS and can not be changed by the SPC/S. This lock-out was originally designed as a security feature; the new system should allow for updating the record by establishing a history record.

Specific Action To Accomplish Task:

Design specifications for SPCTS will be reviewed to ensure that automated reports and records reflect the most current value associated with a seized asset quantity

Action Office: Office of Commercial Operations

Key Target Dates: March 15, 1994

Complete and adequately test the SPCTS

Action Office: Office of Information Management

Key Target Dates: To Be Determined

Train users and implement the SPCTS

Action Office: Office of Commercial Operations

Key Target Dates: To Be Determined

Develop and implement interim procedures

Action Office: Office of Commercial Operations

Key Target Dates: To Be Determined

Responsible Official: Seizures & Penalties Division/Bartoldus

**CYCLE AREA: SEIZED PROPERTY
IMPROVEMENT BEING ADDRESSED: #2B**

Suggested Significant Improvement: Develop and implement alternate procedures to ensure that all seizure activity for fiscal year 1994 is accurately and completely accumulated and reported until such time that the CPTS redesign is implemented. (See #2A)

Customs Response: Customs will perform a reconciliation of automated and manual seizure files and will accurately record complete seizure information. Whenever the automated system cannot accept updated information a notation will be made on the inventory count sheet and submitted to the Regional FP&F coordinator and to the Seizures & Penalties Division. This information will be reconciled as part of our end of the year inventory procedures.

Specific Action To Accomplish Task:

Incorporate referenced alternate procedures into inventory and reconciliation procedures

Action Office: Office of Commercial Operations
Key Target Date: February 11, 1994

Reconciliation of all automated and manual seizure records, including procedure to notate seizure data that can not be updated in CPTS

Action Office: Regional Commissioners
Key Target Dates: January 25 - February 11, 1994

Develop, run and test automated inventory reports

Action Office: Office of Commercial Operations
Key Target Dates: February 2 - 28, 1994

Conduct inventory of seized assets

Action Office: Regional Commissioners
Key Target Dates: February 15 - 25, 1994

Evaluate and Monitor inventory

Action Office: Office of Commercial Operations
Key Target Dates: February 15 - 25, 1994

Conduct review of inventory findings and update CPTS procedures as applicable

Action Office: Office of Commercial Operations
Key Target Dates: April 4 - 29, 1994

Implement procedures for end of the year inventory to include notation of CPTS discrepancies

Action Office: Office of Commercial Operations
Key Target Dates: September 1, 1994

Conduct end of the year inventory for FY '94

Action Office: Regional Commissioners

Key Target Dates: September 15 - 30, 1994

Responsible Official: Seizures & Penalties Division/Bartoldus

CYCLE AREA: SEIZED PROPERTY
IMPROVEMENT BEING ADDRESSED: #3A

Suggested Significant Improvement: Upgrade existing storage facilities or construct new ones to improve the physical safeguarding of seized property.

Customs Response: Customs will accomplish this action item in two phases. Phase I includes the development and accomplishment of a plan to build new storage facilities across the southwest border and in Miami, as well as the review and implementation of improvements at high to medium volume facilities. Phase II includes the evaluation of all remaining facilities to access future needs.

Under Phase I, new facilities have been constructed in Miami and San Diego. Several facilities in the Southwest Region are scheduled for construction during this fiscal year, with additional facilities scheduled for completion by GSA's.

The review of medium to high volume facilities included the evaluation of twenty one district vaults. Where applicable, facility improvements have been identified and funded. Final implementation of these improvements will be jointly monitored by the Office of Security and the Seizures & Penalties Division.

Phase II will begin in July of 1994. An evaluation of all seizure facilities will be conducted jointly by the Office of Security and the Seizures & Penalties Division. This evaluation will document the size and condition of all seizure facilities. This list will be used to access future security needs, and to define revised security standards for the storage of seized assets.

Specific Actions To Accomplish Task:

- o Phase I implementation should be reviewed to identify and resolve obstacles (i.e., the lack of land to build a new facility, etc.).
- o Procurement of facility improvements must be accomplished and monitored.
- o Procedures for evaluating all existing facilities (Phase II) must be developed and implemented.
- o Specifications for a standard seizure vault must be developed to identify minimum security standards.

Key Target Dates:

- | | |
|-------------|---|
| 2/15 - 2/25 | Conduct evaluation of all seizure storage facilities as part of seized asset inventory. |
| 6/1 | Establish minimum security standards for vaults. |
| 6/1 | Evaluate status of Phase I & II implementation. |
| 6/30 | Ensure that all procurements are finalized. |

Responsible Officials:

Charles Bartoldus
Seizures & Penalties Division
(202) 927-0410

Gaston Wallace
Acting Director,
Office of Security

CYCLE AREA: SEIZED PROPERTY
IMPROVEMENT BEING ADDRESSED: #3B

Suggested Significant Improvement: Establish a Customs-wide policy requiring at least two Customs officers to be present when accessing seized property in district vaults.

Customs Response: This action item has been accomplished. The Commissioner has established and implemented a policy requiring that at least two Customs officers be present when accessing seized property in district vaults. A copy of this policy, dated October 4, 1993 is attached.

Specific Action To Accomplish Task: Completed

Responsible Official: Seizures & Penalties Division/Bartoldus

CYCLE AREA: COVERT OPERATIONS

Significant improvements (suggested areas as listed in GAO letter dated January 5, 1994):

1. Procedures should be established to ensure that outstanding advances per the general ledger are reconciled to the SAC office records and any unreconciled differences resolved.
2. Establish procedures to ensure that accounting records relating to resources received and used for covert operations are accurate and complete and that such resources are safeguarded from loss, theft or abuse--periodic reconciliations of cash accounts and separation of duties.

Impact on GAO reporting (as stated in January letter):

Unqualified opinion on covert operations advances and on year end balance of net proceeds assumes reconciliations and accounting for covert operations activity is properly performed. Report internal control weaknesses found in 1993 and highlight effort in fiscal year 1994 to address these problems.

CYCLE AREA: COVERT OPERATIONS
IMPROVEMENT BEING ADDRESSED: #1

Suggested Significant Improvement: Establish procedures to ensure that outstanding advances per the general ledger are reconciled to the Special Agent-in-Charge office records and any unreconciled differences resolved.

Customs Response: Procedures to reconcile investigative advances were developed and are currently being implemented. For the quarter ending March 1993, the National Finance Center began to send quarterly reports to Special Agent-in-Charge offices to reconcile the outstanding advances.

Specific Action to Accomplish Task: Reconcile all outstanding advances in accordance with quarterly reports.

Action Offices: Office of Enforcement Special Agent-in-Charge
Offices
Office of Internal Affairs Regional Offices
National Finance Center

Key Target Dates: On-going

Responsible Official: National Finance Center/Diaforli

**CYCLE AREA: COVERT OPERATIONS
IMPROVEMENT BEING ADDRESSED: #2**

Suggested Significant Improvement: Establish procedures to ensure that accounting records relating to resources received and used for covert operations are accurate and complete and that such resources are safeguarded from loss, theft or abuse, e.g., periodic reconciliations of cash accounts and separation of duties.

Customs Response: In November of 1992, Customs issued new policies which revised and strengthened the procedures for control and accountability of funding and resource utilization in covert operations. The new procedures require more detailed records of receipt and disbursement of appropriated funds and investigative proceeds, certified reconciliation of field records with the records of the National Finance Center, and periodic audits of covert operations. Since issuance of the new policy, approximately 75 audits have been performed. In addition, a task force comprised of representatives from involved Customs disciplines has been formed to verify that the new procedures are effective and efficient.

Specific Action to Accomplish Task: Task force to conduct testing at field and Headquarters sites to verify compliance and effectiveness. In addition, Headquarters Office of Enforcement to perform periodic audits to ensure compliance with procedures.

Action Offices: Office of Enforcement
 Office of Management
 Office of Organizational Effectiveness
 Office of Internal Affairs
 National Finance Center

Key Target Date: Fiscal Year 1994

Responsible Official: National Finance Center/Diaforli
 Office of Organizational Effectiveness/
 Draskovic

CYCLE AREA: FIXED ASSETS

Significant improvements (suggested areas as listed in GAO letter dated January 5, 1994):

1. Perform a 100% inventory of all capitalized property. Customs took a physical inventory as of the end of August for all capitalized property tracked in the Property Information Management System. Our observations of the inventories at several locations identified instances where procedures contained in the written inventory instructions were not being followed. In particular, procedures to ensure that all capitalized items be inspected and traced to the property records were not performed. GAO will visit several additional locations in the near future to test whether capitalized property was completely identified and recorded as of year end. Other capitalized property such as land, buildings and structures have not yet been inventoried. These items should be inventoried and procedures should be performed to "roll this inventory back" to September 30, 1993.
2. A complete integration of property and accounting systems is currently being designed by Customs. In the interim, Customs must reconcile the property and accounting records on a periodic basis and any unreconciled differences be resolved. Customs has performed such reconciliations between FFS and PIMS fiscal year 1993 activity, but we have not yet tested the effectiveness of this process.
3. The responsibilities and duties of Local Property Officers (LPOs) should be revised to provide adequate separation of duties. Customs modified its physical inventory procedures in fiscal year 1993 to ensure proper separation of duties during this process. However, our observations of the inventories at several locations identified instances where these revised procedures were not being followed. In particular, we found that some LPOs (1) were involved in the inventory taking and (2) received the original inventory count sheets directly from the inventory takers. Also, procedures should be established to ensure weapons are properly accounted for and safeguarded. Customs is in the process of developing an enhanced firearms tracking system and establishing new procedures along with

reinforcing existing procedures to improve accountability. GAO will test the effectiveness of this process.

4. Procedures should be established to ensure that equipment values recorded in PIMS are accurately and adequately documented. Specifically, (1) appropriate references to source documents should be recorded in each property file in PIMS, (2) procurement documents should be reviewed or valid estimates established for those items with inaccurate estimated values, and (3) items not in use or damaged should be identified. Customs has taken steps to ensure that new property item acquisitions are accurately valued and recorded in PIMS and that adequate supporting documentation is maintained. In addition, procedures were established to ensure that idle or damaged property is identified and any adjustments made. GAO will test the effectiveness of these procedures.

Customs is in the process of developing a methodology for estimating property values for items lacking procurement documents, but to date, this process has not been satisfactorily completed. Due to the difficulty being encountered by Customs in developing estimated acquisition costs for such items, consideration should be given to devoting resources to develop a methodology to report property at September 30, 1993, at replacement cost. In addition, Customs should continue to use acquisition cost as a basis for valuing all current and future years' acquisitions. The ultimate goal being that eventually all of the older property items that Customs lacks procurement documents for will be disposed of and Customs will be able to report property at both acquisition cost and replacement cost.

5. Establish a cost-effective approach to identifying, accumulating, and reporting the costs associated with the development of in-house software. This process should include identifying all significant in-house developed software currently in use and determine the amount of Customs investment.

At a minimum, Customs should identify all significant software currently being developed in-house and accumulate and report the costs to date associated with these items. Due to (1) the high congressional interest in costs incurred

by agencies of developing software in-house, (2) the significance of the costs that can be involved, and (3) the importance to effective management of having reliable information on such costs, we will have to report that Customs has not maintained complete cost information on computer software. However, we will review and report on Customs approach once one is developed.

Impact on GAO reporting (as stated in January letter):

Unqualified opinion on year end balances--assumes physical inventories, rollback, reconciliations and valuation are done correctly. Report internal control weaknesses found in 1993 and highlight Customs' efforts in fiscal year 1994 to address these problems.

CYCLE AREA: FIXED ASSETS
IMPROVEMENT BEING ADDRESSED: #1A

Suggested Significant Improvement: Perform a 100% inventory of all capitalized property.

Customs Response: A 100% physical inventory of all capitalized property was completed in September 1993. The physical inventory required written verification of existence by inventory takers for all capitalized property recorded in PIMS and certain non-capitalized property (list provided through a sampling technique). Additionally, the physical inventory included inspecting all capitalized personal property to assure items not listed in PIMS were identified and entered into the system.

Specific Action to Accomplish Task: Completed

Responsible Official: Office of Logistics/Smith

**CYCLE AREA: FIXED ASSETS
IMPROVEMENT BEING ADDRESSED: #1B**

Suggested Significant Improvement: Land, buildings and structures have not yet been inventoried. Items must be inventoried and procedures performed to "roll this inventory back" to September 30, 1993.

Customs Response: Valuation methodology from the General Accounting Office is required so the Customs can accurately assign values and satisfy General Accounting Office concerns.

Specific Action To Accomplish Task:

Assistant and Regional Commissioners should review real property lists, confirm existence, and add real property not included

Action Office: Regional and Assistant Commissioners

Key Target Date: February 11, 1994

Customs awaiting receipt of guidance from the General Accounting Office on method to value real property.

Action Office: Office of Logistics

Key Target Date: To be determined after receipt of General Accounting Office guidance

Review the General Accounting Office suggested method and determine cost effective approach to confirm or modify values as appropriate. Implement methodology approach.

Action Office: Office of Logistics

Key Target Date: To be determined after receipt of General Accounting Office guidance

Responsible Official: Office of Logistics/Smith

**CYCLE AREA: FIXED ASSETS
IMPROVEMENT BEING ADDRESSED: #1C**

Suggested Significant Improvement: The General Accounting Office observations of the inventories at several locations identified instances where procedures contained in the written inventory instructions were not being followed by inventory takers. Therefore, the General Accounting Office will visit several additional locations in the near future to test whether capitalized property was completely identified and recorded, as of year end.

Customs Response: In September 1993, all Assistant and Regional Commissioners certified the completion of the inventory, that Local Property Officers acted only in an advisory capacity, items not listed on the PIMS countsheets were researched, etc,. One office failed to complete certifications as required. The Office of Logistics is working with that office to complete their certification. All organizations are being instructed to review and ensure that all capitalized property is recorded in PIMS.

Specific Actions To Accomplish Task:

All offices must assure that all capitalized property is recorded in PIMS

Action Offices: Assistant/Regional Commissioners
Target Date: ASAP

Several offices have outstanding countsheet deficiencies. The applicable offices have been notified of those deficiencies and instructed to resolve them.

Action Office: Assistant/Regional Commissioners
Target Date: ASAP

Responsible Official: Assistant Commissioners
Regional Commissioners
OL/ Smith

CYCLE AREA: FIXED ASSETS
IMPROVEMENT BEING ADDRESSED: #1D

Suggested Significant Improvement: The General Accounting Office observations of the inventories at several locations identified instances where procedures contained in the written inventory instruction were not followed. In particular, procedures to ensure that all capitalized items be inspected and traced to the property records were not performed. These recommended improvements by the General Accounting Office address the FY 1994 Inventory.

Customs Response: The General Accounting Office conducted a comprehensive review of the Customs physical inventory procedures and determined that the procedures were adequate. Training was conducted by the National Logistics Center on inventory procedures for approximately 120 Customs staff.

New procedures for FY 1994 are not necessary, inasmuch as the procedures were approved by the General Accounting Office for the FY 1993 Inventory. The problem, however, was certain offices, where the General Accounting Office observed the inventory, did not follow the procedures.

Specific Action To Accomplish Task:

Improve FY 1994 inventory training to include quick reference card to facilitate the inventory process, modify countsheets to incorporate data required on various forms to simplify the process.

Action Office: Office of Logistics
Key Target Date: Third Quarter - FY 1994

Inventory process enhancements - review the inventory process and streamline, where appropriate.

Action Office: Office of Logistics
Key Target Date: Third Quarter - FY 1994

Ensure that all procedures for inventory taking are complied with.

Action Offices: Regional and Assistant Commissioner
Key Target Date: FY 1994 Inventory

Responsible Officials: Office of Logistics/Smith

CYCLE AREA: FIXED ASSETS
IMPROVEMENT BEING ADDRESSED: #2

Suggested Significant Improvement: While the General Accounting Office recognizes that a complete integration of property and accounting systems is currently being designed by Customs, Customs, in the interim, must reconcile the property and accounting records on a periodic basis, and any unreconciled differences must be resolved.

The General Accounting Office has not yet tested the effectiveness of the reconciliations between FFS and PIMS, for FY 1993.

Customs Response: Customs has developed an automated reconciliation system, utilized by the NFC on a monthly basis, to ensure that all capitalized property items are recorded in the General Ledger and in PIMS. The reconciliation for FY 1993 is complete. Customs is waiting for the General Accounting Office to test the reconciliation process so that any modifications can be made prior to the preparation of the FY 93 financial statements.

Specific Actions To Accomplish Task:

The National Finance Center will document the reconciliation process and prepare a recommended adjustments schedule for the General Accounting Office review and approval.

Action Office: National Finance Center

Key Target Date: February 14, 1994

The General Accounting Office to test the effectiveness of the reconciliation process and notify Customs if modifications are necessary.

Responsible Official: National Finance Center/Diaforli

**CYCLE AREA: FIXED ASSETS
IMPROVEMENT BEING ADDRESSED: #3A**

Suggested Significant Improvement: Responsibilities and duties of local property officers should be revised to provide adequate separation of duties. Customs modified the physical inventory procedures in FY 1993 to ensure proper separation of duties during this process. The General Accounting Office observations of the inventories at several locations identified instances where these revised procedures were not being followed. In particular, Local Property Officers were involved in the inventory taking and received the original inventory countsheets directly from the inventory takers.

Customs Response: As previously stated under item #1D, the General Accounting Office reviewed the inventory procedures and determined that the procedures were adequate. The training included an emphasis on the importance of separation of duties. New procedures for FY 1994 are not necessary, inasmuch as the procedures were approved by the General Accounting office for the FY 1993 Inventory. The problem, however, was certain offices (where the General Accounting Office observed the inventory) did not follow the procedures.

Specific Actions To Accomplish Task:

FY 1994 training will include quick reference cards that clearly, and simply, define the steps involved in the process, and who may perform the steps. Separation of duties to be emphasized in training.

Action Office: Office of Logistics
Key Target Date: Third Quarter FY 94

Assistant and Regional Commissioners must ensure that procedures are followed.

Action Office: Assistant and Regional Commissioners
Key Target Date: FY 1994 Inventory

Responsible Official: Office of Logistics/Smith

**CYCLE AREA: FIXED ASSETS
IMPROVEMENT BEING ADDRESSED: #3B**

Suggested Significant Improvement: Establish procedures to ensure that weapons are properly accounted for and safeguarded.

Customs Response: A Customs multi-disciplinary working group is currently developing an enhanced firearms tracking system known as the Firearms Inventory Tracking System (FITS). One key feature of this system is the incorporation of several additional automated systems related to firearms qualifications, personnel actions and Customs seizures into FITS.

In conjunction with the implementation of FITS, the National Firearms Program Staff (NFPS) has developed tighter inventory control procedures. These procedures require, among other things, tighter control over weapons assigned to offices (rather than individuals) and a visual verification of weapons by supervisors as part of the inventory certification process.

To ensure compliance with the controls over our firearms, NFPS is preparing to institute a policy of random sampling of firearms assigned to individual and field locations. This sampling process will be incorporated into the new system and will validate approximately 2.5% of the firearms inventory on a quarterly basis. Internal controls, spot checks and comprehensive inspections will also be used to ensure compliance with the new system and corresponding procedures.

Specific Actions To Accomplish Task: Much of the work to implement FITS and the new inventory procedures have been completed. In general, key actions and timeframes to be accomplished are:

Review requirements documents and code the programs	
Action Office:	Office of Information Management
Key Target Date:	January 94 - April 1994

Testing of FITS:	
Action Office:	National Firearms Program Staff Field personnel
Key Target Date:	Office of Information Management May 1994 - September 1994

Implement FITS	
Action Office:	National Firearms Program Staff Office of Information Management
Key Target Date:	October 1994

Responsible Official: National Firearms Program Staff/Johnson

**CYCLE AREA: FIXED ASSETS
IMPROVEMENT BEING ADDRESSED: #4**

Suggested Significant Improvement: This suggested improvement concerns placing an accurate value, properly documented, on capitalized property. The General Accounting Office recognizes that procedures have been developed and will test the effectiveness, which includes:

- a. Appropriate references to source documents should be recorded in each property file in PIMS.
- b. Procurement documents should be reviewed, or valid estimates established, for those items with inaccurate estimated values.
- c. Items not in use, or damaged, should be identified.

Due to the difficulty being encountered by Customs in developing estimated acquisition costs for items lacking procurement documents, consideration should be given to devoting resources to develop a methodology to report property at September 30, 1993, at replacement costs.

Customs Response: Customs has been in the process of developing a methodology, acceptable to the General Accounting Office, to be used to determine the value of capitalized personal property. The General Accounting Office advised Customs of an acceptable valuation approach on January 13, 1994. Efforts have been redirected to review categories of personal property and assign replacement costs for balance sheet reporting. Customs was also advised to not change acquisition costs in PIMS when supporting documents for values were not available. Rather, Customs is to concentrate on assuring future acquisition values are properly valued. We are now reviewing categories of capitalized property and developing a replacement methodology.

Specific Actions to Accomplish Task:

Identified Headquarters offices should provide replacement costs for selected capitalized property items.

Action Office: Identified Headquarters Offices
Key Target Date: February 11, 1994

Office of Logistics to determine vehicles and vessels replacement costs.

Action Office: Office of Logistics
Key Target Date: February 11, 1994

Indicate on the financial statements that it is not cost effective to obtain historical costs for capitalized property. Indicate replacement costs on the financial statement using broad categories of property. Document method used to develop replacement costs for the categories.

Action Office: National Finance Center
Key Target Date: March 15, 1994

The General Accounting Office will test the effectiveness of the procedures for documenting equipment values.

Responsible Official: Office of Logistics/Smith
National Finance Center/Diaforli

**CYCLE AREA: FIXED ASSETS
IMPROVEMENT BEING ADDRESSED: #5**

Suggested significant Improvement: Establish a cost-effective approach to identifying, accumulating, and reporting the costs associated with the development of in-house software. Customs should identify all significant software currently being developed in-house and accumulate and report the costs, to date, associated with these items.

Customs Response: Customs does not plan to capitalize in-house developed software. However, we are in the process of establishing a cost-effective approach to identify, accumulate and report the costs associated with the development of in-house software. These expenses will be tracked to determine the expense to be shown on the financial statements.

Specific Actions to Accomplish Task:

Customs and the General Accounting Office are working to resolve issue concerning how to track in-house software staff costs

Action Office: Office of Information Management
National Finance Center
Key Target Date: February 11, 1994

Obtain the cost of developing in-house software currently owned.

Action Office: Office of Information Management
Key Target Date: February 28, 1994

Develop and implement procedures to track in-house developed software expenses beginning with FY 1994.

Action Office: Office of Information Management
National Finance Center
Key Target Date: February 28, 1994

Responsible Official: National Finance Center/Diaforli
Office of Information Management/Balaban

CYCLE AREA: PARTS INVENTORY/AIR OPERATIONS CYCLE

Significant improvements (suggested areas as listed in GAO letter dated January 5, 1994):

1. Procedures should be established to ensure that all items out for repair as of year end are included in the year end parts inventory. Serv-Air, the contractor that manages and maintains Customs' parts inventory is currently in the process of identifying such items. GAO will test the effectiveness of these procedures once the process is completed.
2. Apply procedures to the year end parts inventory balance to ensure that all inventory items are valued at replacement cost and that documentation to support these values is maintained.
3. Establish procedures to identify obsolete parts inventory as of year end and adjust the balance for such items. This could be done by analyzing the data in the CARMAC system to identify items that have had little or no activity during the year. Then the items identified should be physically inspected, their use evaluated, and if deemed obsolete, the inventory balance should be adjusted for such items.
4. A reconciliation of fiscal year inventory activity should be performed and any unreconciled differences resolved. Serv-Air is currently in the process of performing such procedures. GAO will review the reconciliation process once it is complete.

Impact on GAO reporting (as stated in January letter):

Unqualified opinion on year and parts balance assumes identification of repair items, valuation and reconciliation of inventory activity is done correctly. Report internal control weaknesses identified in 1993 and highlight Customs' efforts in fiscal year 1994 to address these problems.

CYCLE AREA: PARTS INVENTORY/AIR OPERATIONS CYCLE
SIGNIFICANT IMPROVEMENT BEING ADDRESSED: #1

Suggested Significant Improvements: Procedures should be established to ensure that all items out for repair at year end are included in the year end parts inventory. The General Accounting Office will test the effectiveness of these procedures once the process is complete.

Customs Response: The EDP edits necessary to accomplish these actions have been programmed in CARMAC and the capability to carry out the suggested GAO improvement is now on line. Starting with the FY 1994 year end annual inventory (September 30, 1994 program) the inventory reports will reflect all items in repair or in transit status. Full and complete financial accountability of all items in the GFP inventory will be accomplished.

Specific Action to Accomplish Task: Completed

Responsible Official: Office of Air & Marine/Pothier

CYCLE AREA: PARTS INVENTORY/AIR OPERATIONS CYCLE
SIGNIFICANT IMPROVEMENT BEING ADDRESSED: #2

Suggested Significant Improvement: Apply procedures to the year end parts inventory balance to ensure that all inventory items are valued at replacement cost and that documentation to support these values is maintained.

Customs Response: The initial programs to update replacement costs and to ensure that each item reported in CARMAC has a valid replacement cost recorded are complete. The EDP edits to create automated system updates are complete. The system is updating each item's replacement cost as new acquisitions occur. Acquisition documents for many of the items in the inventory are non-existent due to the age of the items. Therefore, the replacement for these items can only be updated on a case by case basis since replacement costs become known through DOD Supply Publications and trade journals.

Specific Action To Accomplish Task: Completed

Responsible Official: Office of Air & Marine/Pothier

**CYCLE AREA: PARTS INVENTORY/AIR OPERATIONS CYCLE
SIGNIFICANT IMPROVEMENT BEING ADDRESSED: #3**

Suggested Significant Improvement: Establish procedures to identify obsolete parts inventory as of year end and adjust the balance for such items. This could be done by analyzing the data in CARMAC system to identify items that have had little or no activity during the year. Also, items identified should be physically inspected, their use evaluated, and if deemed obsolete, the inventory balance should be adjusted for such items.

Customs Response: Customs has directed Serv-Air to develop and program on line a "Stock Objective" automated CARMAC enhancement that will calculate stock levels for items based on previous demand data. Edits within the system will prevent acquisition of new items when on hand items are equal to or greater than the projected maximum stock level. Automated reports are also being created that will identify all items over the system authorized levels and the type of activities for these items. These reports will be utilized by Customs and Serv-Air to determine which parts are truly excess to program needs and which items should be retained as insurance items.

The necessary system edits and stock objective formula are currently being programmed which will accomplish the objectives of the General Accounting Office suggested improvement.

Specific Action To Accomplish Task:

Program CARMAC enhancements, evaluate and test program
Action Office: Office of Air and Marine and Serv-Air
Key Target Date: Mid February, 1994

Implement program
Action Office: Office of Air and Marine and Serv-Air
Key Target Date: April 1, 1994

Responsible Official: Office of Air and Marine/Pothier

CYCLE AREA: PARTS INVENTORY/AIR OPERATIONS CYCLE
SIGNIFICANT IMPROVEMENT BEING ADDRESSED: #4

Suggested Significant Improvement: A reconciliation of the Fiscal Year inventory activity should be performed and any unreconciled differences resolved. The General Accounting Office will review the reconciliation process once it is complete.

Customs Response: The year end inventory program is being changed to include reports which will account for parts in repair or transfer status. In addition, the inventory program will be run at the end of the fiscal year to eliminate any transitional time period for reconciliation. The necessary EDP edits, automated programs and contractual requirements are complete and in place to accomplish this suggested improvement.

Specific Action to Accomplish Task: Completed

Responsible Official: Office of Air & Marine/Pothier

CYCLE AREA: TREASURY

Significant improvements (suggested areas as listed in GAO letter dated January 5, 1994):

1. Review all reconciliations and verify that all BCA accounts and suspense accounts--if they exist as we think--are cleared and properly resolved into their appropriate account. Also, if certain amounts are identified as not reconcilable, those amounts should be identified and a proposal for writeoff--similar to what was done on the forfeiture fund--prepared to bring these accounts into balance.

2. Also, procedures should be put in place, including emphasis from the Commissioner's office to all personnel, that timely attention be given to Treasury account reconciling items that need to be resolved. Often, because of Customs decentralized organization resolution of an item may be contingent on input from the field, that in some instances has not been timely.

Impact on GAO reporting (as stated in January letter):

If problems are found in this area it will be highlighted in our internal control reports and will result in a disclaimer of opinion for funds at Treasury. If reconciled with or without a proposed writeoff, the written off amount will be reported--if it occurs--but Customs efforts to get things reconciled will be highlighted.

CYCLE AREA: TREASURY
IMPROVEMENT BEING ADDRESSED: #1A

Suggested Significant Improvement: Review all reconciliations and verify that all BCA accounts and suspense accounts, if they exist, are cleared and properly resolved into their appropriate account.

Customs Response: Customs is reconciling and verifying all BCA accounts and suspense accounts as well as clearing and resolving the exceptions into the appropriate accounts but the effort is backlogged for 1993 statements and will be for 1994. Customs is evaluating the cause for the BCA transactions and will recommend appropriate system and procedural changes.

Specific Action to Accomplish Task: Continue to reconcile and verify adjustments to resolve outstanding deposit adjustments before they go to BCA. Evaluate the BCA resolution process to determine what can be done to resolve the differences before the transaction is on the BCA. Redesign system to eliminate cause for BCA transactions.

Action Office: National Finance Center
Automated Information Management Systems
Office of Information Management

Key Target Dates: 1994 study and resolve problems causing BCA adjustments.
1995 resolve outstanding BCA balances.
1996-97 System and Redesign.

Responsible Official: National Finance Center/Diaforli
Automated Information Management
Systems/ Graves
Office of Information Management/Riley

CYCLE AREA: TREASURY
IMPROVEMENT BEING ADDRESSED: #1B

Suggested Significant Improvement: Identify and propose as a write-off, similar to what was done on the forfeiture fund, any non-reconcilable amounts.

Customs Response: Customs is identifying those items that are not supportable and will propose write-offs as appropriate.

Specific Action to Accomplish Task: See above

Action Office: National Finance Center

Key Target Dates: On-going

Responsible Official: National Finance Center/Diaforli

CYCLE AREA: TREASURY
IMPROVEMENT BEING ADDRESSED: #2

Suggested Significant Improvement: Develop and implement procedures, including emphasis from the Commissioner's office to all personnel, that timely attention be given to Treasury account reconciling items that need to be resolved.

Customs Response: Customs has developed procedures to reconcile Treasury account items and the Commissioner emphasized this effort in correspondence to Customs Assistant and Regional Commissioners, managers, supervisors and employees.

Specific Action to Accomplish Task: Field Offices to follow national procedures to reconcile Treasury account items.

Action Offices: Assistant and Regional Commissioners

Key Target Dates: On-going

Responsible Official: National Finance Center/Diaforli

CYCLE AREA: PROCUREMENT/ACCOUNTS PAYABLE

Significant improvements (suggested areas as listed in GAO letter dated January 5, 1994):

1. Customs efforts to have field locations identify what goods and services were received but not invoiced by year end has not been effective. Field locations have not been responsive according to NFC officials. An extensive review of all unliquidated obligations, open invoices, and unmatched receiving reports (where goods or services were received but have not been invoiced) needs to be conducted to identify the status of such items and get them properly recorded for September 30--this includes a good cutoff test that would review all disbursements over a designated dollar amount made to date in fiscal year 1994 to identify ones that paid involves on goods received prior to September 30, 1993. Also, systems designs need to be sought to enable all purchases to be recorded through the accounts payable system and authorization procedures need to be put in place to ensure that all purchased items are recorded in the system. In addition, open receipts and invoices should be followed upon on routinely, at a minimum monthly. For this effort to be effective emphasis will have to come from the Commissioner, that field personnel record receipt of items timely. This is a area where consideration should be given to having accounting personnel--that report to NFC--placed in field locations to ensure that all the necessary things that have to occur, do, as it relates to the accounting function. It seems that these types of procedures have historically been low priority in the field. And while they may not be that significant to the operational aspects of field locations they are critical to accurate and timely financial reporting.

2. Policies and procedures should be established to ensure that (1) all expenses relating to interagency agreements are completely and accurately recorded, (2) revenue is recorded only when related costs have been incurred, and (3) related receivables are properly recorded.

3. It would be helpful to us if Customs could identify any examples of where compliance with procurement regulations has impacted their ability to get something done in a timely manner. Also, as part of its "reinventing" efforts Customs should reevaluate its approach to overseeing contacts. Our experience in reviewing this area has been mixed, however, we did find instances where the person responsible for overseeing the contract appeared to have little to no idea of what goods and services under the contract had actually been received and putting almost total reliance on the contractor. From a reinventing perspective that would seem to suggest that you should either put something in place that will effectively oversee contracts or conclude that the risk is low and do nothing--we would highly recommend the former and not the latter.

Impact on GAO reporting (as stated in January letter):

If Customs successfully assesses accounts payable it will improve our ability to render an unqualified opinion on amounts generated through procurement/accounts payable assuming there are not any other mitigating issues that would preclude us from doing so on a given account. For example, the procurement aspects of fixed assets maybe fine but if the maintenance (valuation and existence of already acquired assets) is in error it would preclude use from rendering a clean opinion of fixed assets even though the procurement aspect is fine. We will report any control problems found but also highlight any Customs improvement efforts that meaningfully impact this area.

**CYCLE AREA: PROCUREMENT/ACCOUNTS PAYABLE
IMPROVEMENT BEING ADDRESSED: #1**

Suggested Significant Improvement: (1) Conduct an extensive review of all unliquidated obligations, open invoices, and unmatched receiving reports (where goods were received but not invoiced). Each item needs to be recorded as of September 30, 1993. (2) System changes need to be developed to allow all purchases to be recorded through the accounts payable system and authorization procedures need to be put in place to ensure that all purchased items are recorded in the system. (3) Open receipts and invoices should be followed up on routinely, at a minimum monthly.

Customs Response: Customs is in the process of compiling accounts payable information for FY 1993. Customs intends to continue its manual efforts to compile accounts payable information but ultimately plans to expand ARRS and CLAS automated systems as part of the AIMS improvements. Changes, however, to the system are contingent upon implementation of Department-wide procurement system. The Commissioner has advised all staff members to record the receipt of goods and services timely. Open invoices and receiving date are monitored regularly by Customs accounting and field staffs.

Specific Action to Accomplish Task: Field offices are directed to record the receipt of goods and services in a timely manner in accordance with national procedures.

Action Office: Assistant and Regional Commissioners
National Finance Center

Key Target Dates: On-going

Responsible Official: National Finance Center/Diaforli
Automated Information Management
System/Graves

**CYCLE AREA: PROCUREMENT/ACCOUNTS PAYABLE
IMPROVEMENT BEING ADDRESSED: #2**

Suggested Significant Improvement: Procedures should be established to ensure that (1) all expenses relating to interagency agreements are completely and accurately recorded, (2) revenue is recorded only when related costs have been incurred, and (3) related receivables are properly recorded.

Customs Response: In April, 1993, Customs established procedures to account for revenue and expenses for interagency agreements. Because the flow of documents is not automated, the accuracy of data is contingent upon information received from the operational offices. To ensure completeness periodic reconciliations were conducted on outstanding interagency agreements. In FY 1994, active agreements will be monitored by on-line automated recording of data in a project cost system.

Specific Action to Accomplish Task: Field offices are directed to comply with procedures for documenting interagency agreements.

Action Office: Assistant and Regional Commissioners
National Finance Center

Key Target Dates: Ongoing
FY 1994 - Enter agreements into system

Responsible Official: National Finance Center/Diaforli
Automated Information Management
System/Graves

**CYCLE AREA: PROCUREMENT/ACCOUNTS PAYABLE
IMPROVEMENT BEING ADDRESSED: 3**

Suggested Significant Improvement: Identify examples where compliance with procurement regulations has impacted their ability to get something done in a timely manner. Also, Customs should explore from a reinvention perspective, the method Customs uses to oversee contractor performance.

Customs Response: Customs is currently engaging in several initiatives to explore areas of potential improvement in the procurement process, including: (1) working with the Department of Treasury in proposing changes to laws and regulations; (2) utilizing process improvement groups to identify areas where we can streamline and improve services; (3) assessing changes in our written guidance; (4) providing additional training to appropriate personnel; and (5) attempting to retain and build staff to improve contract administration.

Specific Action to Accomplish Task:

Continue to participate in "workouts" with the Department and other bureaus regarding major changes in solicitation and contract review procedures

Action Office: Office of Procurement

Key Target Date: On-going

Process map Bankcard and Interagency Agreement procedure

Action Office: Office of Procurement

Key Target Date: March 1994

Address the following identified problems:

- Reorganization of RPC to include the "help desk"
- Automation of CF-148s (requisitioning document)
- Acquisition Planning Initiatives
- Improvements in Contract Administration
- Basic Purchasing Agreement (BPA) Rollover
- Increased training of contracting officers and Contracting Officer's Technical Representatives
- Increased training of Bankcard users

Action Office: Office of Procurement

Key Target Date: FY 1994

Explore innovations in electronic commerce, including planned pilot use of an Air Force automated small purchase system (GATEC), to improve and streamline service and move toward a "paperless" small purchase environment

Action Office: Office of Procurement

Key Target Date: FY 1994

Responsible Official: Office of Procurement/Kasna

CYCLE AREA: BUDGET

Significant improvements (suggested areas as listed in GAO letter dated January 5, 1994):

1. Prepare a Reconciliation to Budget Statement which shows budget authority, obligations, and outlays as reported to Treasury/OMB and reconcile to total operating expenses.
2. Establish procedures and accounting/cost systems to enable reporting of expenses by both budget program and expense object classification.
3. Procedures should be established to ensure that obligations are liquidated upon receipt of goods or services. In addition, clarify guidance on classifying charges by object class codes and periodically review for compliance.
4. Procedures should be established requiring obligations to be periodically reviewed, and if necessary, deobligated.
5. Establish procedures to ensure that the amount of obligations on canceled balances is accurately and completely disclosed in the notes to the financial statements.

Impact on GAO reporting (as stated in January letter):

Unqualified opinion on budget line items and disclosures and Reconciliation to Budget Statement assumes (1) Reconciliation to Budget Statement is accurately prepared and amounts are supportable and, (2) accounting and reporting of expenses by program, unliquidated obligations, and obligations on canceled balances are accurate and complete. Report initial control weaknesses found in 1993 and highlight efforts in final year 1994 to address these problems.

CYCLE AREA: BUDGET
IMPROVEMENT BEING ADDRESSED: #1

Suggested Significant Improvement: Prepare a Reconciliation to the Budget Statement which shows budget authority, obligations, and outlays as reported to Treasury/Office of Management and Budget and reconcile to total operating expenses.

Customs Response: Customs is preparing a reconciliation of actual budgetary expenditures for FY 1993 and will keep the General Accounting Office apprised of our efforts.

Specific Action to Accomplish Task: Prepare report for 1993 statements.

Action Offices: National Finance
Budget Division
Automated Information Management Systems

Key Target Dates: May 15, 1994

Responsible Official: National Finance Center/Diaforli

CYCLE AREA: BUDGET
IMPROVEMENT BEING ADDRESSED: #2

Suggested Significant Improvement: Establish procedures and accounting/cost systems to enable reporting of expenses by both budget program and expense object classification.

Customs Response: This is a long range effort by Customs. Customs is in the process of developing a cost accounting system and will determine the feasibility of compiling costs data by budget program and expense object classification. To date, two prototypes have been developed for the Virgin Islands and Puerto Rico and we are currently working on defining Headquarters costs activities.

Specific Action to Accomplish Task: Develop procedures and cost accounting system.

Action Offices: National Finance Center
Budget Division
Automated Information Management System
Office of the Comptroller

Key Target Dates: No earlier than FY 1995

Responsible Official: National Finance Center/Diaforli

CYCLE AREA: BUDGET
IMPROVEMENT BEING ADDRESSED: #3A

Suggested Significant Improvement: Establish procedures to ensure that obligations are liquidated upon receipt of goods or services.

Customs Response: Customs system needs to be expanded to include liquidation of outstanding obligation balances for all goods and services. This will include modifications of CLAS, ARRS and FFFS systems. However, Customs is prohibited from pursuing these system enhancements pending the Department of Treasury's study of a Department-wide procurement system.

In the interim, Customs has developed and implemented manual procedures to liquidate the obligation (plus record the payable and expense) for the year-end statements. Field offices are requested to complete a form at year-end. Additionally, information for certain other obligations is available from an ARRS generated report.

Specific Action to Accomplish Task: Field offices are directed to complete year-end statements forms in accordance with Customs manual procedures to liquidate the obligations.

Action Offices: Assistant and Regional Commissioners

Key Target Dates: On-going

Responsible Official: National Finance Center/Diaforli

CYCLE AREA: BUDGET
IMPROVEMENT BEING ADDRESSED: #3b

Suggested Significant Improvement: Clarify guidance on classifying charges by object class codes and periodically review for compliance.

Customs Response: Customs issued a directive in March, 1993, that clarifies guidance on classifying charges by object class code.

Specific Action to Accomplish Task: Field offices are directed to follow clarifying guidance and the National Finance Center will periodically review field office submissions to ensure compliance.

Action Offices: Assistant and Regional Commissioners
National Finance Center

Key Target Dates: On-going

Responsible Officials: National Finance Center/Diaforli

CYCLE AREA: BUDGET
IMPROVEMENT BEING ADDRESSED: #4

Suggested Significant Improvement: Establish procedures requiring obligations to be periodically reviewed, and if necessary, deobligated.

Customs Response: Customs established procedures and quarterly reviews are required to determine the validity and need of the unliquidated balance.

Specific Action to Accomplish Task: Field offices are directed to conduct quarterly reviews and, if necessary, deobligate obligations.

Action Offices: Assistant and Regional Commissioners

Key Target Date: On-going

Responsible Officials: National Finance Center/Diaforli

CYCLE AREA: BUDGET
IMPROVEMENT BEING ADDRESSED: #5

Suggested Significant Improvement: Establish procedures to ensure that the amount of obligations on canceled balances is accurately and completely disclosed in the notes to the financial statements.

Customs Response: The National Finance Center and the Budget Division have developed procedures to track and report obligations on cancelled balances. These procedures will be implemented for FY 94.

Specific Actions to Accomplish Task:

Completed

Key Target Dates (If Applicable):

Responsible Official (if Applicable):

NFC - Diaforli
Budget - Hamilton

CYCLE AREA: FINANCIAL REPORTING

Significant improvements (suggested areas as listed in GAO letter dated January 5, 1994):

1. Customs needs to perform an in depth review of every reported financial statement amount to ensure that amounts reported "as of" September 30, 1993--typically balance sheet accounts--have an itemized detail that can be identified and supported that equals the reported amount. Also, for all amounts that are reported "for the period"--typically income statement accounts and activity information--it should be verified that the detailed transactions that compose the balance can be specifically identified and supported. As discussed in our analysis done on other cycle areas we do not believe in some instances that Customs can get to this information for 1993, but it is imperative that procedures be put in place to ensure that this problem is completely eliminated in 1994.

2. We would like to have a dialogue as to what the most useful financial statement presentations might be and what implications the result will have as to the kind of information Customs should ensure its systems are capable of generating. To date we have been engaging with Customs personnel on the financial statements and we will continue to do so.

Impact on GAO reporting (as stated in January letter):

Forced amounts will be reported and disclaimed in our report, however, to the extent effective procedures are in place we will highlight the improvements made as part of our report. If all of the needed disclosures are made and other improvements to make the statements more useful are done, it will further strengthen our reporting on Customs efforts to improve its reporting capability.

CYCLE AREA: FINANCIAL REPORTING
IMPROVEMENT BEING ADDRESSED: #1A

Suggested Significant Improvement: Perform an indepth review of every reported financial statement amount to ensure that amounts reported "as of" September 30, 1993 -- typically balance sheet accounts -- have an itemized detail that can be identified and supported that equals the reported amount.

Customs Response: For 1993, Customs plans to be able to support all ending balances for assets and liabilities but equity balances will be derived from the details supporting the assets and liabilities. The equity balances will not be derived from entries in the General Ledger.

Specific Action to Accomplish Task: One-time adjustment to correct the equity General Ledger accounts will be made once the asset and liability balances are successfully audited.

Action Office: National Finance Center

Key Target Dates: FY 1993 - Statement balances supported
FY 1994 - Adjustment to equity accounts

Responsible Official: National Finance Center/Diaforli

CYCLE AREA: FINANCIAL REPORTING
IMPROVEMENT BEING ADDRESSED: #1B

Suggested Significant Improvement: Verify, for all amounts that are reported "for the period" -- typically income statement accounts and activity information -- that the detailed transactions that compose the balance can be specifically identified and supported.

Customs Response: For FY 1993, Customs plans to be able to verify income statement items.

Specific Action to Accomplish Task: Ensure documents support income and expense items.

Action Office: National Finance Center

Key Target Dates: February 1994

Responsible Official: National Finance Center/Diaforli

CYCLE AREA: FINANCIAL REPORTING
IMPROVEMENT BEING ADDRESSED: #2

Suggested Significant Improvement: Initiate dialogue with General Accounting Office personnel as to what the most useful financial statement presentations might be and what implications the result will have as to the kind of information Customs should ensure its systems are capable of generating.

Customs Response: Customs plans to continue to meet with the General Accounting Office on financial statement disclosures.

Specific Action to Accomplish Task: Meet with the General Accounting Office

Action Office: National Finance Center

Key Target Dates: On-going

Responsible Official: National Finance Center/Diaforli

CYCLE AREA: FMFIA

Significant improvements (suggested areas as listed in GAO letter dated January 5, 1994):

1. Guidance and training should be developed for assessing control risk in Customs' operations and for analyzing and testing the adequacy of controls. Customs has developed such guidance and is presenting it to the staff during their new Management Control Review Course. GAO will evaluate the effectiveness of this guidance and training as we review the fiscal year 1993 FMFIA process.

2. Procedures should be established to ensure that corrective action plans address the underlying cause of the problem. In addition, the effectiveness of implemented corrective action plans should be tested to ensure that the related weaknesses are actually corrected. Customs has taken steps to address these issues. However, GAO has not yet evaluated the effectiveness of these procedures.

Impact on GAO reporting (as stated in January letter):

Report internal control weaknesses identified in 1993 and highlight Customs' efforts in fiscal year 1994 to address these problems.

CYCLE AREA: FMFIA
IMPROVEMENT BEING ADDRESSED: #1

Suggested Significant Improvement: Develop guidance and training for assessing control risk in Customs operations and for analyzing and testing the adequacy of controls.

Customs Response: Customs accomplished much of the above suggested significant improvement during FY 1993. Specifically, Customs:

- Developed a course designed to teach managers and program staff to analyze and evaluate the adequacy of management controls for Customs programs. The course was implemented and 75 Customs personnel were trained in FY 1993
- Developed a manual for evaluating, testing, and overall assessment of the adequacy of management controls as part of its new course.
- Developed and implemented a new in-house process for performing the reviews of fiscal and administrative systems under FMFIA Section 4 and performed a number of reviews utilizing this process. These reviews utilized improved methodologies, better statistical sampling and testing of transactions, and were much more extensive in extent and scope than previous Section 4 reviews.
- Improved its self assessment process by expanding and strengthening its annual review process. Emphasis was placed on obtaining more and better information from Assistant Commissioners on weaknesses found in their programs, on ensuring that the results of CFO audits, Inspector General audits, Section 4 reviews and other internal reviews were included in the review process, and on ensuring adequate review and deliberation of the meaning of those results by Customs top management, Departmental officials, and the Inspector General before the Customs Annual FMFIA Report was sent forward.
- Implemented Business Process Improvement training which is designed to provide managers with the concepts and tools to understand, analyze, and if necessary redesign and improve their work processes.

Specific Action To Accomplish Task:

Schedule six additional management control evaluation courses and mandatory training for anyone involved in conducting these reviews or creating procedures as part of the self assessment process.

Action Office: Office of Management Controls

Key Target Date: March 1994

Refine the Section 4 review process and schedule reviews as part of this on-going cyclical process to evaluate the degree of conformance to General Accounting Office standards.

Action Office: Office of Management Controls

Key Target Date: September 1994

Responsible Official: Office of Management Controls/Grothe

**CYCLE AREA: FMFIA
IMPROVEMENT BEING ADDRESSED: #2**

Suggested Significant Improvement: Establish procedures to ensure that corrective action plans address the underlying cause of the problem and that corrective actions are tested to ensure that the related weaknesses are actually corrected.

Customs Response: Customs has taken many of the actions necessary to accomplish the above suggested significant improvement. The remaining actions are listed below under, "Specific Actions to Accomplish Task" Specifically:

- Customs developed a new management controls evaluation course which stresses the identification of the root causes of weaknesses and the development of effective corrective action solutions.
- Greater emphasis has been placed on initial staff to staff interaction and communication in identifying material weaknesses for the FMFIA process and in formulating what would be an effective corrective action plan for specific weaknesses.
- Customs developed an action plan to specify which validations of corrective actions for corrected material weaknesses would be done during the year, and several formal validations were initiated.

Specific Actions To Accomplish Task:

Customs has formed a group which will analyze recurring program issues which have surfaced in internal and external reviews since 1990. The purpose of the analysis is to provide us with the status of the recommended corrective actions and to assess the effectiveness of such actions. As a result of the analysis, it will be determined whether additional action is necessary in each program area.

Action Office: Office of Management Inspection
Target Date: Ongoing

In connection with the above, Customs will conduct mid-year reviews of all existing action plans for open material weaknesses to determine (1) whether the action plans are addressing the root causes of the problem; (2) the status and progress made under the action plans; and (3) any problems or obstacles which have arisen in the implementation of the action plans.

Action Office: Office of Management Controls
Target Date: September 1994

Customs will establish a formal validation schedule for closed material weaknesses to be validated, including a timetable for completion of these validations and who will perform the validation in each case.

Action Office: Office of Management Controls

Target Date: February 1994

Responsible Officials: Office of Management Controls/Grothe
Office of Management Inspections/Draskovic

THE COMMISSIONER OF CUSTOMS

January 24, 1994

WASHINGTON, D.C.

Mr. Donald H. Chapin
Assistant Comptroller General
U.S. General Accounting Office
441 G Street, NW
Washington, D.C. 20548

Dear Mr. Chapin:

The Customs Service appreciates the opportunity to review and comment on the draft report on Customs Financial Management. Customs generally agrees with the recommendations in the draft report and is committed to making efforts to accomplish the objectives of the recommendations. Plans have been developed to address the issues in the draft report. However, in some cases, implementation of comprehensive corrective action will require effort over the long term. In other cases, the recommended action may require further study to develop alternatives which will allow the objectives to be met but which will present fewer implementation difficulties. The following are Customs comments on the GAO report and recommendations.

GAO REPORT

As an overlay to any specific corrective action planned by Customs in response to findings, consideration should be given to the ongoing efforts of the Automated Commercial System (ACS) Selectivity Redesign Staff to provide a framework within which Customs can provide increasing assurance that trade enforcement and revenue collection efforts are optimized. The goals of Selectivity Redesign are in accordance with GAO's concerns that Customs be able to provide assurances that the collection of revenue is maximized and that there be a reliable means of measuring overall compliance with trade laws in order to optimize the use of its inspection and enforcement resources.

The Redesign Project was established in September 1992, in response to GAO's General Management Review and the agency's own recognition that a comprehensive plan to improve Customs Selectivity System was necessary. The Project Staff is addressing enhanced targeting of imports and compliance measurement of large scale, critical industries that greatly impact revenue. The system is being developed in consonance with the Trade Enforcement Strategy and revenue enhancement goals.

In preparation for a new Customs-wide Compliance Measurement Program, test measurements have been conducted in selected districts of five industries; automobiles, ADP, fiberboard, telecommunications and steel. A revenue gap shortfall was identified collectively across the five industries. In addition, compliance measurements have been expanded to each district in FY 94. Baseline compliance rates for fifteen additional commodities will be established in order to obtain detailed information regarding revenue shortfalls. In keeping with these efforts, standard procedures are being established and personnel are being trained in every district in order to facilitate the institutionalization of the compliance measurement program throughout Customs. In addition, the Redesign Group, in conjunction with the Offices of Inspection and Control and Commercial Operations is developing options for full implementation of the compliance measurement program, which incorporates compliance measurement of manifests, bills of lading, and the entry/entry summary process.

The efforts of this group, while necessitating long range implementation, are key in moving Customs towards a more dynamic, responsive, and efficient accomplishment of the goals of the Service.

RECOMMENDATIONS

- Develop and implement, in conjunction with Customs Chief Financial Officer, a strategy for inspecting cargo from both high and low-risk carriers to help provide reasonable assurance that all cargo delivered is accurately and completely identified on manifest and entry documents. Carriers undergoing such inspections should be randomly selected to ensure that they are representative of all carriers.

Agree. The Office of Inspection and Control is currently working with the Selectivity Redesign staff in the development and testing of national manifest and bill of lading compliance procedures. On November 1, 1993, a bill of lading compliance test was initiated in nine east coast ports. The test will conclude on January 31, 1994. Following this test, other ports along the Gulf and Pacific coasts will begin the test procedures. Additionally, a Landed Quantity Verification (LQV) initiative for manifest compliance has begun, and test ports will begin this initiative in the first quarter of 1994.

- Obtain reliable data on carriers' use of the Automated Manifest System as a percentage of all manifest submissions so that expanded use of the system can be more accurately monitored.

Agree. Customs agrees that expanded use of and monitoring of the Automated Manifest System (AMS) system is necessary. Customs can and does maintain statistics on system use at the bill of lading level.

A comprehensive view of the total population of bills of lading can be obtained through review of AMS and the CF-16, Workload Summary Report. AMS gives us the total number of shipments which were filed electronically. In addition, the CF-16 provides statistics on bills of lading filed manually by vessel. By comparing the data in AMS with that in the CF-16, we can determine the percentage of shipments which were filed electronically. In order to validate the accuracy of the CF-16, Customs plans to alert field personnel to the necessity of capturing accurate data in this area. In addition, Customs will review CF-16 data samples in order to verify its accuracy and to review the methodology used in data collection. Further, Customs will continue to encourage increased use of the system by carriers.

- Consider requiring all documents, including manifests, to identify goods in a uniform manner, such as through the use of harmonized tariff codes.

Agree. Increased standardization is required to correlate manifest data with entry documentation. The recent passage of the Modernization Act provided the statutory framework within which imposition of a requirement to use Harmonized Tariff, United States of America (HTUSA) codes or some other standardized descriptor can be more readily studied for feasibility. Since requiring the carrier industry to "classify" commodities is without precedent, the impact on industry and on international agreements will be reviewed and any cost or related effects assessed. Customs plans to work with the carrier industry and GAO to gauge what the concerns would be in implementing such a requirement or in determining what alternatives are available that would meet this goal.

- Monitor implementation of the new procedures for accounting for in-bond transfers to ensure that they address the weaknesses that have been identified. In conjunction with this effort, provide personnel

involved in maintaining data on in-bond transfers with clear and detailed guidance and adequate training on complying with the new procedures.

Agree. Customs has developed a new automated in-bond system in AMS which contains more detailed and up-to-date data. The Service will continue to monitor the implementation of the system to ensure that weaknesses previously identified are corrected. Additionally, Customs will also continue to pursue eliminating and/or reducing the reliance on in-bond procedures.

The Office of Inspection and Control and the Office of Automated Commercial Systems have issued written guidance and provided training to field offices regarding the conversion to the new in-bond system. Both offices will continue to issue detailed guidance and provide necessary training on complying with all new procedures for the new system.

- Require district offices to maintain perpetual inventory records of goods held in bonded warehouses and FTZs that they are responsible for overseeing.

While Customs intends to reinforce monitoring activities in bonded warehouses and FTZs, we have fundamental concerns with this recommendation in terms of costs versus benefits. We think that our resources should be applied in a manner that is proportionate to the relative risk and significance of the bonded warehouse and FTZ operations. Customs believes that improved monitoring of inventory levels in FTZs and bonded warehouses is desirable. However, as we understand the recommendation, it envisions an automated inventory system for bonded warehouses and FTZs. The significant number of very critical automation priorities in the Service precludes devoting resources to this project. We would, however, like to work with GAO in calculating the risks, determining the appropriate response, and placing these in the context of our strategic plans.

In addition, Customs plans to expand its compliance measurement program to this area and to reinforce existing control mechanisms, i.e., conducting annual risk assessments and spot checks, to provide efficient oversight.

- Enhance ACS so that the district offices could use this system to maintain perpetual records of merchandise quantities at each warehouse and FTZ.

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The concerns expressed above apply equally to the enhancement of ACS for the recommended purpose. Customs is exploring re-engineering and redesign of its automated commercial processes. While it is the agency's long term goal to use automation to control operations, the construction of separate modules to address FTZs and bonded warehouses at this time is not a priority when compared to other automation initiatives and the resource requirements of these initiatives. In fact, the addition of separate modules would be counter-productive to ACS redesign efforts. We believe that increased use of compliance measurement, including risk assessment and spot checks, will address GAO's oversight concerns.

- Direct the Assistant Commissioner for Inspection and Control and the Assistant Commissioner for Commercial Operations, as appropriate, to: emphasize to district offices the importance of spot checks of bonded warehouses and monitor this activity to ensure that districts comply with Headquarters directives.

Agree. Over the signatures of the two aforementioned Assistant Commissioners, a memo will be sent to all Regional Commissioners reminding them of the districts' responsibilities for completing an annual risk assessment for each bonded warehouse and conducting not less than one spot check annually in each warehouse.

- Require district offices to periodically spot check all FTZs that have not been audited or surveyed for over a year.

Agree. The Assistant Commissioner, Inspection and Control, will send a memo to each Regional Commissioner requiring that each district annually complete a risk assessment for the general-purpose zones within each district and conduct the required number of spot checks of the activated general-purpose zones within the district.

- Provide more detailed guidance on the use of spot check worksheets so that they will capture complete information on these inspections.

Agree. The Office of Inspection and Control will draft a new spot check worksheet which will capture information such as the Inspector(s) name conducting the check; specific controls or requirements reviewed; which items were physically counted; verbal warnings, if any, issued. The worksheet will be attached to the Risk Assessment/Spot Check memorandum.

- Develop a means of automatically entering information needed to verify drawback claims into ACS so that liquidators can use the system to automatically verify drawback claims;

Agree. Customs plans to fully automate the processing of drawback claims to include the capabilities contained in this recommendation. The Customs Modernization and Informed Compliance Act contains new drawback provisions which require new or revised regulations. Once those regulations are formulated and agreed to Customs will begin full-scale system development.

- Until this capability is developed and implemented, require that liquidators use representative sampling procedures for reviewing drawbacks that relate to multiple entry summaries;

Agree. The drawback portion of Customs regulations, Part 191, is being revised as a result of new provisions in the Customs Modernization and Informed Compliance Act. As part of this revision, it is Customs plan to provide instructions to the field on the use of representative sampling procedures for retrieval and review of entry summaries related to drawback claims.

- Enhance ACS so that historical information on drawback claimants such as accelerated claim privileges, excessive claims previously filed, overdue receivables, and regulatory audit results are available to liquidators in a national data base;

Agree. The new automated drawback process will include a claimant database that will contain historical information on drawback claimants. Action on this portion of automated process will be developed in detail once the revised drawback regulations are formulated and agreed to.

- Require that liquidators review this database to ensure that special privileges such as accelerated drawback payments are granted only to claimants who have consistently complied with Customs claim filing requirements;

Agree. When the automated drawback system is operational, we will ensure that the liquidators review the special privilege database before privileges are granted, including accelerated payment. In the meantime, the national directive on accelerated

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payment requires that all drawback offices review each drawback claim that includes a request for accelerated payment to determine whether: the claim is properly prepared; the contract is valid; and that the claimant has not been delinquent in their dealings with Customs. Drawback offices have been instructed to perform this review before a decision to grant accelerated payment is made. We will stress to the Regions the importance of compliance with the directive and will work with them this year to develop internal controls to ensure these procedures are followed.

- Enhance the bond liability module to monitor the sufficiency of bonds posted for drawback transaction, including the ability to alert liquidators when coverage is exceeded.

Agree. The new automated process will have the capability to track bonds for accelerated payment. With respect to the bond liability portion of the Automated Commercial System, it assists drawback offices in determining the status of a company's bond on a national basis. This capability is, however, limited in its current version, and a task force has been formed to review the centralization of all bond filing and storage. If this is found to be feasible, the discrepancies in drawback bond management would be resolved.

We look forward to working with you in making improvements which will result in a more responsive, efficient and progressive Customs Service. If any additional information is required, your staff may contact J. Tony DelMoral at (202) 927-0194.

Sincerely,



George J. Weise
Commissioner

APPENDIX 2.—DEPARTMENT OF JUSTICE RESPONSE TO INFORMATION
REQUESTED FOR THE HEARING RECORD



U. S. Department of Justice

Office of Legislative Affairs

Office of the Assistant Attorney General

Washington, D.C. 20530

DEC 23 1993

COMMERCE, CONSUMER &
FINANCIAL AFFAIRS SUBCOMMITTEE

December 23, 1993

The Honorable John M. Spratt, Jr.
Chairman, Subcommittee on Commerce, Consumer,
and Monetary Affairs
Committee on Government Operations
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

Reference is made to the October 5, 1993, request of the Commerce, Consumer, and Monetary Affairs Subcommittee for case tracking data regarding illegally transshipped textile and apparel merchandise. This response was prepared with the assistance of the Customs Service of the Department of the Treasury, which agency compiles the most detailed textile transshipment offense data.

You will recall that we were asked to determine the number of Customs Service textile transshipment matter referrals to United States Attorneys' Offices, the division between declinations and matters accepted for prosecutive action, and the number of resulting indictments and convictions.

Although the scope of the request was fiscal year 1993, it is appropriate to review data for a period of several years, because referrals, indictments, and convictions rarely occur in the same fiscal year in these complex, document-intensive prosecutions. Nationwide, in fiscal year 1991, 16 Customs Service textile referrals were accepted for prosecution and four referrals were declined by United States Attorneys' Offices. In fiscal year 1992, 24 matters were accepted for prosecution while 12 were declined. In fiscal year 1993, 18 matters were accepted for prosecution and four were declined.

In fiscal year 1991, according to Customs Service data, 44 entities or individuals were indicted for textile transshipment offenses; 39 entities or individuals were convicted nationwide during the same period. In fiscal year 1992, there were 69 entities or individuals indicted and 55 entities or individuals convicted. In fiscal year 1993, 43 entities or individuals were indicted and 38 were convicted. Of course, indictments and convictions often occur in consecutive fiscal

years, so it is not possible to calculate from this data the percentage of successful indictments.

Though varying time lags between investigative matter presentation, prosecutor acceptance, indictment, and conviction--events which rarely occur in the same fiscal year -- frustrate efforts to reach conclusions regarding "success rates" for Customs criminal presentations, some general conclusions can be made. Nationwide during the three-year period (fiscal years 1991 through 1993), approximately 75% of textile transshipment matters referred to United States Attorneys' Office for possible prosecution were accepted for that purpose. It is presumed, though not documented in available Customs records, that the majority of declined matters led to forfeitures or fines through administrative processes. Each accepted matter yielded, on the average, between two and three convicted entities or individuals.

The majority of Customs Service investigations do not lead to referrals for criminal prosecution by United States Attorneys' Offices. A review of Customs Service data regarding textile customs violations investigated, including but not limited to transshipment offenses, reveals that the number of investigative matters greatly exceeds the number of eventually indicted cases. Administrative and civil penalties result from many of those matters. During the three-year period (fiscal years 1991 through 1993), 117 investigative case files were opened by the Customs Service field office in Atlanta -- including matters which, upon investigation, did not merit any further action. Boston opened 30 files, Chicago - 36, Cleveland - 60, Dallas - 23, the District of Columbia/Virginia - 22, Denver - 14, Detroit - 24, El Paso - 10, Southern District of New York - 330, Los Angeles - 128, Miami - 64, Mobile - 33, New Jersey - 65, New Orleans - 17, Philadelphia - 22, San Diego - 18, Seattle - 41, San Francisco - 29, San Juan - 21, Tampa - 31, and Tucson - 26. Though precise data is not available, it is estimated that approximately half of the investigations initiated, which may have been the result of referrals from Customs Inspectors as well as informant tips and developments in other investigations, led to seizures, penalties, or criminal prosecution.

As was explained at the Subcommittee hearing, Department of Justice statistics are compiled by statutory offense and do not permit isolation of textile transshipment offenses. Title 18, United States Code, sections 541 through 553, statistics from all United States Attorneys' Offices reflect false classification, duty evasion, relanding, smuggling, unlawful repacking, false duty refund claims, destruction of customs documentation, and related customs offenses. During the first 11 months of fiscal year 1993, 82 cases involving 124 defendants resulted in indictments within that range of criminal customs violations. There were 33 guilty pleas from defendants and two guilty verdicts during that period for those customs offenses. There were 147 proposed defendant counts declined during that period.

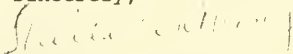
During the entirety of fiscal year 1992, there were 109 indicted cases involving 192 indicted defendants for that series of criminal customs violations. There were 27 guilty pleas from defendants in addition to one guilty verdict during that fiscal year. There were 156 proposed defendant counts declined during that period. In fiscal year 1991, there were 104 indicted cases involving 152 indicted defendants. Guilty pleas were entered by 38 defendants during that period and four defendants were convicted. There were 245 proposed defendant counts declined during that period. Comparison of Department of Justice statistics for all customs violations with Customs Service textile violation data suggests that referral declination rates are lower for textile customs violation referrals than for the entire category of customs violations.

We were also asked to determine whether domestic defendants are distinguished from foreign defendants in Customs Service or Department of Justice case statistics. Neither tracking system includes that distinction. Accordingly, it would be necessary to review individual investigative files to make such determinations.

The Subcommittee also expressed interest in references by the Customs Service to modifications under consideration in the standard of knowledge regarding textile description and initial source required of exporters and importers. Of particular interest were the levels of culpability considered actionable as a false declaration by exporters or importers in incidents of textile transshipment. We have confirmed that the Customs Service references at issue related solely to administrative fine and seizure policies, rather than to the elements of existing criminal customs violations. The Customs Service and the Textile Transshipment Task Force, on which Department of Justice Civil Division and Criminal Division representatives serve, are considering potential revisions in documentation requirements which could facilitate the proof of criminal customs offenses by United States Attorneys' Offices. Such modifications in the design of reporting obligations of participants in textile importation would not alter the existing criminal intent element of applicable criminal statutes.

If I can be of further assistance, please do not hesitate to contact me.

Sincerely,



Sheila F. Anthony
Assistant Attorney General

APPENDIX 3.—STATEMENT PRESENTED FOR THE RECORD BY HOWARD SWINIMER, CUSTOMS INSPECTOR, ON BEHALF OF THE NATIONAL TREASURY EMPLOYEES UNION



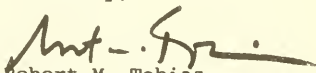
November 5, 1993

The Honorable John M. Spratt
Committee on Government Operations
Subcommittee on Commerce, Consumer and Monetary Affairs
337 Rayburn House Building
Washington, DC

Dear Mr. Chairman:

Thank you for the opportunity to submit the enclosed statement for the Record on the hearing regarding Transshipments. The enclosed statement was written by Howard Swinimer, a Customs Inspector for 22 years. As you will note, Mr. Swinimer has first hand knowledge of the problems of transshipments and the role of Customs Inspectors and Import Specialists in eradicating this problem. If I can answer additional questions in this important area, please feel free to call Debbie Billet-Roumell of my staff at 202-508-3719.

Sincerely,


Robert M. Tobias
National President



STATEMENT OF

HOWARD SWINIMER

BEFORE THE

HOUSE GOVERNMENT OPERATIONS COMMITTEE
SUBCOMMITTEE ON COMMERCE, CONSUMER, AND MONETARY AFFAIRS

ON

TRANSSHIPMENTS

NOVEMBER 2, 1993

My name is Howard Swinimer and I am a U.S. Customs Inspector at Dulles Airport. I have been employed for 22 years as an Inspector.

Just as import rules and tariff restrictions have changed over the past 22 years, so have the patterns and purposes of transshipping merchandise from one country to a second or third country to the United States. Transshipment practices have grown dramatically. The United States' rapidly changing trade policies reflect the dramatic changes that have taken place throughout the world. As new countries are born, tariff restrictions are added or removed and the benefits and liabilities attached to the importation of a product by virtue of its country of manufacture are constantly shifting. This creates special challenges for Customs inspectors and import specialists at our nation's ports of entry.

Although the Customs Service is constantly striving to improve its intelligence gathering capabilities to target only the most high risk shipments for examination; positive enforcement results are usually dependent upon actual physical examination of goods at the border before they enter the commerce of the United States. For example, when a particular country loses GSP (Generalized System of Preference) status, goods which were formerly duty free from that country are suddenly dutiable. By transshipping these goods to a country that still has GSP

status and disguising their origin as that of the GSP country, the goods can be entered into commerce in the U.S. at a great loss of revenue to the United States.

Cellular telephones were manufactured in Hong Kong for one prominent U.S. company when Hong Kong was eligible for GSP. Although analysis of shifts in quantity of such goods from Hong Kong to other Asian countries indicated possible transshipment, it was not until an inspector examining a large shipment of such cellular phones from Malaysia lifted the plastic plate covering a paper sticker marked "Made in Malaysia" and found a "Hong Kong" marking die-sunk in the item itself. This finding was the beginning of a still ongoing investigation that has produced millions in revenue to the United States.

For some commodities, the issue is greater than revenue in that it impacts on U.S. policy to prohibit imports from certain countries. Whether it be Iranian carpets or caviar - Cuban cigars or lobsters, transshipment attempts to circumvent U.S. policy to prohibit trade to these and other countries. In the early 70's, an inspector's knowledge of lobsters helped identify lobsters entered as from Spain as actually the product of Cuba.

Recently caviar has been an item of transshipment from both the USSR and Iran. While caviar from the USSR was not prohibited as that from Iran, it was subject to column II rates of duty.

These two countries were the producers of the best quality and most prized caviar. One importer established a microcosm of all transshipment operations in a freezer at Dulles Airport. He imported Iranian and Russian caviar from Canada and entered it in a foreign trade zone (the freezer) and co-mingled it with domestic caviar. He repackaged the caviar in the "trade zone" and then substituted the domestic caviar for the Iranian and Russian caviar and presented documents indicating that the foreign caviar was exported with no payment of duties when in fact it was entered into the commerce of the U.S.

Perhaps the most prevalent form of transshipment involves textile products. Many countries such as China have quotas which limit the quantity of various goods that can legally be imported into the U.S. As these quotas begin to fill, these Chinese garments become international travellers, visiting the Middle East, the Caribbean and other Asian countries before entering the U.S. Unlike most visitors, they immediately claim the citizenship of these countries they have only visited. Sometimes they are already marked with their new citizenship before they leave China, other times they are stripped of their citizenship ("Made in China" label) and nationalized in their new country at a warehouse in the foreign trade zone of that country.

Jump teams have visited several countries and gathered information on manufacturing capability for particular factories.

These visits have provided evidence that factories were merely repackaging operations incapable of manufacturing the textile products which they had imported or intended to import to the United States. With the evidence that these teams uncover, boarding inspectors can target manifested and unmanifested shipments from these factories. Frequently the original packaging or bill of lading will have been changed and only a visual examination will uncover the transshipped goods. It is important that these shipments be identified before they have entered the commerce of the United States.

Just as "legitimate" importers seek to mask the origin of their transshipped goods before they enter the U.S., so do smugglers of narcotics. In order to minimize the possibility of their illegal shipments being examined when they enter the U.S. from a known high risk narcotics area such as Thailand or Columbia, they try to transit an area not as known for narcotics trafficking.

It is easier to create a new identity for a transshipped item when the only challenge to its discovery is a computer that will accept any information that is typed into it. It is up to Customs to assure that the facility to international trade that the "paperless", "examination" environment creates, is checked by predictable and unpredictable examination of goods before they enter the commerce of the United States. Nothing increases

compliance as much as fear and sureness of apprehension if one is not compliant.

Frequently in a "customer" oriented environment that the government is trying to create, one forgets that the real customers that the U.S. Customs Service must satisfy are not merely the special interest group of importers and brokers, but more importantly the American citizenry and manufacturers who want a level playing field for American made goods to compete against imports and who want illegal imports, especially narcotics to be kept from entering the United States. The Customs Inspectors and Import Specialists of the U.S. Customs Service ask your help in recognizing and supporting their efforts to prevent the transshipment of prohibited, illegal and restricted goods into the commerce of the United States.

APPENDIX 4.—MAY 28, 1992, SPEECH BY PETER K. NUNEZ, FORMER ASSISTANT SECRETARY OF ENFORCEMENT, DEPARTMENT OF TREASURY, TO THE CUSTOMS LAWYERS ASSOCIATION

**PETER K. NUNEZ
ASSISTANT SECRETARY (ENFORCEMENT)**

**CUSTOMS LAWYERS ASSOCIATION
NATIONAL PRESS CLUB
May 28, 1992**

"Commercial Fraud — Has the Pendulum Swung Too Far?"

Good Afternoon. It is a pleasure to join the working Customs bar in Washington at this luncheon. Groups such as this that have a balanced membership of government and private sector lawyers with strong common interests are too rare in my view. Yet they are extremely valuable. Harvey Fox and the other officers who have worked hard in recent years to bring the Customs Lawyers Association back into prominence are due a debt of thanks for creating a this fine forum.

"Commercial Fraud— Has the Pendulum Swung Too Far?" When it was suggested to me that I speak on this topic I realized that for some of you it could only prompt a counter-question: "In what direction?" Those of us who are in the enforcement business face an occupational hazard, that is, of becoming too defensive. It is easy for

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us to drift into the belief that the whole world views us only as tough cops who interfere with getting business done.

For most of the decade of the 80's, relations between the Customs Service and much of the importing community were, to say the least, somewhat strained, owing to what was perceived as overly aggressive Customs enforcement of our import laws. In addition, some members of the business community thought that export and munitions control seizures were being handled in a too-zealous manner.

As a consequence of the strain that developed between Customs and the trade community, there was a steady drumbeat of criticism of Customs. Many in the Customs bar, perhaps some of you in this audience, authored op-ed pieces in the Journal of Commerce and other publications criticizing Customs for excessive measures, and virtually every bar and trade association with any connection to international trade regularly held conferences at which Customs was roundly lambasted without any contradiction from the audience. This constant criticism led to widespread acceptance of the notion that

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Customs was a renegade bureaucracy, and Customs commercial enforcement efforts suffered a loss of credibility.

I certainly won't suggest that none of this criticism was justified. Like any large organization, Customs has individuals who exercise bad judgment and make mistakes. But much of the criticism was based on a limited number of well-known anecdotes that became more embellished with each retelling and that eventually led to a loss of reputation for the entire agency and a disrespect for its proper efforts to enforce the law.

This whole situation has been aggravated by the unpopularity of the laws that Customs enforces. I have no doubt that some of you believe that much U.S. trade law is based on benighted policies. I am sure, for example, that there are many who believe that the whole textile quota program should be dismantled, that the voluntary restraints agreements on steel products should never have been arranged, that economic sanctions programs are misguided, and that the country-of-origin marking law is just another non-tariff trade barrier. Because opponents of these programs have been unable to

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block or repeal their enactment, opposition has been transferred to their enforcement.

All of this has led to some loss of credibility for Customs commercial enforcement, to a defensiveness on the part of Customs employees about their commercial enforcement programs, and to a greater hesitancy with respect to commercial law enforcement.

Without denying that there have been some real cases of abuse of enforcement powers by Customs, and certainly without wishing to see Customs enforcement powers abused in future, I want to suggest that we need to restore some balance to this situation. Increasingly, business people, and especially domestic business, are asking for tougher enforcement. They perceive themselves as under threat from a proliferating range of trade abuses which can only get worse if not deterred by an aggressive enforcement response.

Even some of you in the trade bar have suggested to me privately that Customs commercial enforcement needs to be revitalized. Recently, I was invited to lunch by a prominent member of

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the customs and trade bar whose name shall, of course, go unmentioned. This fellow makes his living, and a good living I might add, representing importers and exporters who have gotten caught in the switches with the Customs Service. He told me frankly that over the last few years he has noticed among his clientele a growing contempt for Customs enforcement capabilities, and a greater brazenness in their attempts to circumvent U.S. trade laws. To put it bluntly, what he actually told me is that the bad element within the trade community is no longer afraid of Customs, that they believe that Customs' examinations and audits are so infrequent and so cursory that there is little chance that they will be caught. He contrasted this with the attitude of his clientele toward the Internal Revenue Service, which he says is widely respected and, frankly, feared.

Now, there are two ways I can interpret this rather extraordinary revelation from ^{one} somewhat who, in the professional sense, is an adversary of the Customs Service. I can, and do, assume that he is an honest person who believes that the law should be enforced and respected. Or, worst case, I can assume that he is being disingenuous and that his real concern is with the loss of

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business that results from diminished trade law enforcement. But either way, his testimony is credible because it reveals his sincere belief, as an informed observer, that trade laws are widely disregarded, and that Customs enforcement is not an effective deterrent.

Accordingly, it will not surprise many in this room to find this Assistant Secretary, after a sixteen-year career as a federal prosecutor, stating that we need to be concerned that we may have gone too far away from the direction of vigilance and vigorous trade enforcement. There is more that we can do, and more we are beginning to do, to protect the integrity of U.S. trade laws and the international trading system.

But before I talk about specific commercial enforcement initiatives, let me restate for the record that the United States has a strong commitment to seeking a liberalized trade environment. This has been reflected in our positions in the Uruguay Round, our contributions to past multilateral and bilateral trade agreements, and our current efforts to bring a North American Free Trade Area to

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fruition. Yet free trade must be fair trade, and it must operate according to the rules. Nothing could be more effective in destroying the faith of American producers and workers in a free trade environment than to see abusers of the system go uncaught and unpunished.

At this point, let me highlight the aspects of commercial enforcement that will be most challenging over the next decade,

and talk a little about how we may respond to these challenges.

NORTH AMERICAN FREE TRADE AGREEMENT

One challenge which is very much on the minds of people in Washington these days is the impending North American Free Trade Agreement, or NAFTA. NAFTA is not, as most of you know, unconditional free trade. NAFTA will offer several types of preferences to goods produced in Canada and Mexico, provided certain conditions are met. To a great extent, support for NAFTA among many sectors of the public will depend on their confidence that Customs is able to enforce these conditions for NAFTA preference.

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Consequently, one of our major commercial enforcement priorities over the next decade will be to ensure that Customs has both the resources and the commitment to enforce the NAFTA. Customs must have the import specialists and the data processing capacity it needs to analyze NAFTA trade for the purpose of identifying likely violations, and it must have an audit capacity adequate to identify violations and to carry out a level of examinations sufficient to create a deterrent to false claims for preference.

We know from our experience with the U.S.-Canada Free Trade Agreement that these enforcement efforts will be unpopular. On the Canadian side, the audit questionnaire that Canadian Customs sent to many U.S. exporters excited much resentment and controversy. And on our side, the much misunderstood U.S. Customs audit of Honda has caused Customs' auditors to be subjected to criticism that is not warranted by the facts.

But the bottom line is that neither in the current free trade agreement with Canada nor in the upcoming NAFTA are the benefits unconditional. Congress and the public expect that Customs

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will enforce the conditions for preference in these agreements, and we shall make it a top priority to fulfill these expectations.

TEXTILE FRAUD

Whether or not you believe that textile quotas are a good idea, you cannot deny that they are firmly entrenched in U.S. law and trade policy, and that there is strong support for their enforcement. Moreover, it is beyond denying that attempts to circumvent the textiles quotas are widespread and frequent.

Consequently, enforcement of the quotas on textiles and apparel will be a major element in Customs' commercial enforcement program for years to come.

Operation Q-Tip

Recently, we have enjoyed some success uncovering a major scheme to circumvent the textile quotas. One of our most publicized enforcement programs, Operation Q-Tip, focused on the willful and concerted efforts on the part of individuals, including officials of the quasi-governmental China National Import and Export Company, to violate Customs laws and regulations in several ways. One of the principal schemes detected involved the

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systematic undervaluation of merchandise through concealment of fees paid for quota and commissions.

Lost revenues may run into millions of dollars. Much evidence was uncovered indicating that merchandise manufactured in China is routinely being transshipped through other countries for the purpose of concealing Chinese origin, to circumvent quota restrictions. This transshipment network is surprisingly vast, and involves transshipments and false origin claims through countries on every continent other than Australia and Antarctica.

In the course of Operation Q-Tip federal agents executed a total of 139 Federal search warrants and 46 seizure warrants in the New York City Area and at other locations nationwide. Some eight to ten million documents and just over \$10 million in bank accounts, cash, real estate and vehicles were seized. Earlier this month the U.S. Attorney for the Southern District of New York indicted three firms and four individuals holding responsible positions within these firms. These indictments include charges for fraudulent importation, false description, conspiracy, and income tax evasion.

Textile "Jump Teams"

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Although Operation Q-Tip is the largest investigation yet undertaken by Customs, or perhaps any Federal agency, it does not comprise all of Customs efforts in textile trade fraud enforcement. For the last 20 months, textile production verification teams, so-called "jump teams", composed of import specialists and special agents, have focused on suspicious foreign exporters of textiles and apparel to confirm that they have, in fact, the capability to produce in that country the goods being shipped to the United States. Not surprisingly, these jump teams have regularly confirmed suspicions that goods from other countries subject to U.S. textiles quotas are being merely transhipped through the exporting country. Out of 694 factories inspected worldwide for production verification, 553 were found to be transhipping goods produced elsewhere and were prevented from exporting to the United States.

FORCED LABOR

Another area of concern is products manufactured abroad through the use of forced labor. Particularly since the Tienamen Square massacre and the imprisonment of Chinese citizens critical of their government, there has been great interest on the part of the

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Congress, the media, and the public in the use of prison labor to produce goods exported from China to the United States. In the last six months alone, the Customs Service has on several occasions taken action to prevent importation of articles believed to be produced by forced labor in the People's Republic of China. In addition, Customs has established a Chinese Forced labor Task Force and is currently negotiating a memorandum of understanding with the Chinese Government on forced labor. Success in this endeavor will not, unfortunately, end the widespread use of forced labor in Chinese prisons. But it will help to protect our economy and our workers from the products of forced labor while allowing legitimate trade with China to continue.

However, China is not the only country where this practice is or has been a problem. Not long ago, the focus of the forced labor controversy focused on the former Soviet Union. In fact, as a recent article in Newsweek magazine pointed out, conditions of coerced labor tantamount to outright slavery exist in many more places than the public is aware.

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Beyond our abhorrence for a practice that we find morally offensive and politically objectionable, it has long been U.S. law and policy that the U.S. labor force, which is paid an appropriate wage and provided with other benefits such health insurance and workmen's compensation, should not have to compete with products produced with labor that is cheap because it is coerced. Therefore, it is entirely appropriate that Customs act aggressively to identify and prevent the importation of such products.

This will without doubt provoke angry and indignant responses from importers whose shipments are stopped, and there will likely be renewed exclamations about abusive enforcement and accusations that the Customs Service is conducting its own foreign policy. But the law is clear and actually rather inflexible on this matter, and it would be wrong for Customs to respond to criticism by withdrawing from its responsibility.

INTELLECTUAL PROPERTY

The fourth and final area of commerce in which Customs must take an active enforcement posture is in the protection of intellectual

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property rights. This is a very important area, one where abuses are widespread and, in some areas, rampant.

American companies and industries, which spend billions of dollars on research and development, have been damaged in their profitability and competitiveness by unfair trade practices, including the infringement of copyrights, trademarks, patents, and other intellectual property rights. The International Trade Commission estimates that U.S. companies lose somewhere between \$40-60 billion dollars per year because of inadequate protection of intellectual property rights.

Some of that loss results from infringement of intellectual property rights by goods imported directly into the United States. To counter this, Customs is installing new equipment, including scanning electron microscopes which will closely examine semiconductor chips, and automated computer retrieval system is now operating as part of the Customs-wide automated commercial system.

However, as you might guess, most of the problem lies with the failure of our trading partners to give adequate protection to

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Intellectual property. Because customs administrations around the world are particularly well situated to stop this pirating, U.S. Customs has a unique opportunity to work with its counterpart agencies around the world. Indeed, the U.S. Customs Service's intellectual property efforts are held in high regard in the international community. The Customs Cooperation Council in Brussels invited U.S. Customs to design and conduct a two-day symposium for the 112 CCC member countries in Brussels on intellectual property rights issues. The CCC is now discussing worldwide measures for increased customs enforcement of intellectual property. But Customs must and is working more directly with the countries that are major sources of counterfeit goods, including Taiwan, South Korea, Hong Kong and many others, dare I say, the usual suspects?

SHAPING THE ENFORCEMENT RESPONSE

At this point I have told you that I believe that greater emphasis must be given to commercial law enforcement, and I have told you in which areas our priorities must lie. Now let me talk about some of the specific measures we must take to make

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commercial enforcement more effective.

Resource Allocation

First, we must reexamine the allocation of our resources to ensure that to the extent possible we provide the tools needed to be effective. Over the last decade or so Customs has greatly broadened its enforcement missions, and has expanded its efforts in many non-traditional areas. Although these new initiatives have often been rewarded, we do not want them to distract us from our fundamental missions, which are those that cause Customs to be a bureau of the Treasury Department. The Customs Service has distinguished itself in a variety of enforcement assignments. It is obviously tempting for Congress and the public to want to involve Customs in new enforcement initiatives, many of which are exciting and, as the French say, *au courant*. Therefore, the first task before us is to work with Congress and with OMB to ensure that Customs traditional revenue and trade enforcement missions are recognized as central missions and supported accordingly.

Enhanced Training

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Another important initiative must be to improve the quality and frequency of training provided to Customs employees on commercial enforcement. On many occasions you and your colleagues have told me and told Commissioner Hallett that Customs employees don't understand the laws and regulations they are responsible for enforcing. In many specific cases called to my attention I have found that to be untrue. But as a general matter I acknowledge that U.S. trade laws are extremely complex and becoming more so every year. And I acknowledge also that, like any large organization, Customs has its share of employees who have been around for a while and who rigidly stick to the old way of doing things even as conditions change. And so I regard it as highly important that we take the time and make the effort to train Customs people properly, and to retrain them when they need it.

In many instances the private sector can help us with that training. For example, in April of this year, seventeen special agents and a representative from the Office of Trade Operations were afforded specialized training in techniques to verify textile production.

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This training was conducted with the cooperation of domestic fiber, yarn, fabric, and apparel manufacturers.

More Agressive Prosecution

Most commerical violations are appropriately dealt with by imposition of civil penalties, and I would expect that practice to continue. But frequently we encounter a case in which the fraud is so egregious as to warrant criminal prosecution. In the past, because of the complexity and time-consuming nature of commercial fraud cases, we have encountered some reluctance on the part of U.S. Attorneys to prosecute cases involving commecial fraud. As a former U.S. Attorney, I can understand why this happens. Every U.S. Attorney has a caseload of drug offenders caught red-handed, and he can knock these cases out of the park with the regularity of Harmon Killebrew in a home run derby. Needless to say, he can develop a public reputation as an effective prosecutor and a bulldog crime fighter.

Economic Crime Council Priority

But difficult as it is, U.S. Attorneys must take on this burden, and we are doing what we can to see that they do accept this

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responsibility and to help them carry it out. Among other things, the Customs Office of Enforcement and my office at Treasury were instrumental in having customs fraud raised to a level of "special emphasis" by the Chairman of the Economic Crime Council. As such, the Attorney General identified Customs fraud as a matter rising to a level of national significance and requiring prosecutorial priority by all U.S. Attorneys. To help U.S. Attorneys understand the nature and importance of our tariff and trade laws, Customs has worked with Department of Justice staff to develop a course curriculum and instructor staff for a U.S. attorney training program. Those sessions will be regional in nature to assure equal representation by all possible U.S. Attorney offices. Presentations will be made jointly by Special Agent case agents and prosecuting U.S. Attorneys of successful major Customs fraud investigations.

Balancing Enforcement Against Facilitation

Finally, we must strike and maintain the right balance between enforcement and facilitation. Certainly, I acknowledge that the balance a few years ago may have been tipped against facilitation,

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and I believe that Commissioner Hallett is on the right track in this respect.

Through most of my remarks today I have emphasized the enforcement side. As I hope I have made clear, there are some excellent reasons for that. However, this is a good point to return to the title of the speech and to the pendulum. That pendulum always seems to be on the move rather than coming to rest on the balance point of the "Golden Mean" between an extreme emphasis on enforcement at the expense of trade on the one hand or an extreme emphasis on facilitation of trade at the expense of good law enforcement.

As most of you know, in the past two and a half years, we have placed renewed emphasis on trade facilitation. Some would argue that we are now operating in a "pro-facilitation" environment. Among the reasons for this are the arrival of a new Commissioner, Carol Hallett, who has cultivated a high degree of communication and trust with various sectors of the business community.

Treasury fully supports the maintenance of a mutually respectful relationship between Customs and industry. We understand the

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Importance of removing unnecessary impediments to the flow of trade into and out of the United States. Both Customs and Industry have placed greater emphasis on voluntary compliance with tariff and trade laws, along the lines of the I.R.S. model. Part of this is a reaction to the sheer volume of trade and the limited nature of our resources. It is also an effort to take full advantage of an automated and increasingly paperless environment. Our commitment to facilitation, and to expediting the movement of goods across U.S. borders, is reflected in the proposed Customs Modernization Act, on which we hope Congress will act this year.

On the other hand, there remains widespread concern that a more streamlined and automated statutory approach will open more loopholes for fraud. Concerns have been raised by the General Accounting Office, our own Treasury Inspector General's Office,

and by the Congress, in its oversight function, that existing violations are going undetected and that some of the violations we are catching are not the most serious ones. There is concern that too much merchandise is bypassing any examination, and that Customs

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Inspectors are being instructed to adhere strictly to automated selectivity criteria in determining which packages to inspect, even when their own experience and intuition suggests that an examination is needed.

We take these concerns very seriously, and we shall be conducting a vigorous internal examination of our procedures and guidelines to see if our enforcement efforts need to be tightened further.

Again, the challenge is to find that elusive balance point. Optimum enforcement would mean physical examination of every entry. Maximum facilitation would mean passively waving most merchandise through without checking. Neither of these extremes is acceptable. And perhaps we can never escape that swinging pendulum. Where we put our emphasis is always going to depend on changing factors. Among these are the state of the U.S. and world economies, patterns of trade, and the balance at any particular time between the incentives to voluntarily comply with the law versus the incentives to violate it.

APPENDIX 5.—NOVEMBER 10, 1993, LETTER FROM CHAIRMAN JOHN M. SPRATT, JR., AND NINE OTHER MEMBERS OF CONGRESS TO PRESIDENT CLINTON AND NOVEMBER 16, 1993, RESPONSE FROM PRESIDENT CLINTON

Congress of the United States

House of Representatives

Washington, DC 20515

November 10, 1993

The Honorable William J. Clinton
The President
The White House
1600 Pennsylvania Avenue
Washington, D.C. 20500

Dear Mr. President:

We represent textile and apparel workers. Your assurances to help them would help us vote for NAFTA. They would also help your Administration by backing up your pledge to offset the impact of NAFTA on any who may be adversely affected by it.

Here briefly is what we seek:

First, Customs should adopt stricter rules and procedures to detect and deter transshipment of textile/apparel imports and quota circumvention in other forms. Customs has the authority to implement new rules without new legislation. This would help cushion the impact of increasing apparel imports from Mexico. If current transshipments are equal to \$4 billion, and if Customs can stop one-fourth of this traffic by cracking down, the imports excluded will almost equal the current value of apparel imports from Mexico.

Second, new rules and procedures alone are not enough, nor is the strict rule of origin in NAFTA. None of these rules is self-executing; and experience has proven that the rules will be flouted if they are not rigorously enforced. If the rules are to mean anything, Customs should have trained personnel to enforce them.

Third, the Bush Administration made substantial concessions in textiles and apparel in the Uruguay Round before you took office. Your Administration should recognize that these concessions plus NAFTA take a heavy toll on the American textile/apparel industry, and in fairness, you should resist any new concessions of significance in this sector in order to close the Uruguay Round.

These generally are the assurances we seek. Let us spell them out more specifically:

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(1) Customs Enforcement.

(A) NAFTA provides that if textile/apparel products are to move duty-free in North America, they must be manufactured from the yarn-stage forward in North America. This strict rule of origin is a plus for NAFTA, but the rule is only as strong as its enforcement.

The Fiscal Year 1995 budget is being assembled, and consistent with deficit reduction, serious consideration is being given to a cut below baseline in the budget for the Customs Service and other federal agencies. Reductions in the budget of the Customs Service would lead to a reduction in its enforcement staff. As a budget-saving device, this would be counter-effective, because Customs is the government's second largest revenue producer; and less Customs enforcement tends to mean lower revenues. Instead of cutting Customs, the Administration should resolve to hold the Customs budget at the current services baseline, adjusting for inflation and adding \$10 million specifically for textile/apparel enforcement to supplement resources already available.

This \$10 million supplement would go to hire 115 new Customs specialists to police transshipment and other forms of circumvention, and to back up the enforcement staff with adequate operating funds, specifically travel funds for "jump team" officers dispatched to investigate exporting countries suspected of transshipment. Fifty of these new employees should concentrate exclusively on textile/apparel transshipments outside the North American Free Trade Zone.

(B) To enforce NAFTA's rule of origin as it applies to textiles and apparel, Customs needs trained personnel based in the southwest who are dedicated to this task. Specifically, Customs should hire an additional 25 auditors, 30 import specialists, and 10 criminal investigators. They should all be stationed in the southwest and assigned solely to this task.

(C) There is a paucity of data on transshipment and circumvention, and there is no regular flow of information from the field to the Commissioner of Customs and the Committee for Implementation of Textile Agreements (CITA) on pending investigations, "jump team" dispatches, indictments, and seizures. The Customs agents and investigators engaged in this work should be required to report monthly to the Commissioner or Deputy Commissioner of Customs and to CITA and Congress on cases under investigation; "jump team" dispatches and results; seizures and shipments denied entry; the quantity and value of such shipments; indictments; fines and penalties; the names of the

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exporters and importers involved; and the originating and transit countries involved.

Basically, what we are seeking is what your Administration has already committed itself to do. USTR issued a rebuttal to Perot's polemic against NAFTA. In answering his charge that Customs is stretched too thin on the southwestern border to "cope with increased imports from Mexico," USTR responded:

Customs is already increasing manpower and expanding its facilities on the border...Moreover, enforcement of NAFTA preference will not be done exclusively at the border...it will be done primarily by Customs personnel going directly to factories in Mexico and Canada to confirm that goods are manufactured there, rather than transshipped from other countries. Finally, customs agents, through laboratory analysis and tracing of shipments, can differentiate between shirts made in China and those made in Mexico (NAFTA and the Perot-Choate Book, Statement of Ambassador Mickey Kantor, page 46).

(2) Administrative Steps to Enforce Textile/Apparel Quotas.

(A) Certificate of Origin: The Customs Service should issue regulations requiring importers of textile and apparel goods into the U.S. to sign a certificate of origin. The regulations could be modeled on the certificates of origin required by NAFTA. Importers would be required to use due diligence in the accuracy of the certificates, and would be subject to penalty if the information is found to be incorrect and the importer is found not to have been diligent. Customs should require these certificates to be submitted well in advance of the goods' physical arrival in the United States. This would give Customs time to verify the visas without forcing a pile-up of goods on the docks and a delay in legitimate trade.

(B) Period for Redelivery/Liquidated Damages: In cases where Customs finds that textile/apparel goods have been transshipped but is unable to prove intent or negligence, current regulations make it difficult to impose a penalty if the violation is discovered more than 30 days after Customs has released the imported goods. Once the 30 days have run, neither

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the exporter nor the importer is likely to face sanctions. Since it normally takes Customs more than 30 days to find that products have been transshipped, the 30 day period is too short. Customs should issue new regulations extending the bond and re-delivery period to six months.

(C) Mitigation Guidelines: The Customs Service's guidelines for penalties imposed pursuant to 19 U.S.C. 1592 should be modified to include textile transshipment as an aggravating factor. Under its authority in 19 U.S.C. 1592 and 19 U.S.C. 1618, the Treasury Department has issued penalty guidelines for violations of Customs law. These guidelines are in 19 C.F.R. 171 Appendix B. In their current form, these guidelines do not allow Customs to consider the fact that an importer is transshipping when Customs assesses penalties. As a result, the guidelines treat an importer who transships the same as an importer guilty of any other negligent conduct. Transshipment is deliberate fraud and should be a material factor in assessing penalties. Making transshipment an aggravating factor will give Customs broader authority to bear down on transshipments and raise the disincentive to shipping textiles illegally into our markets.

(3) GATT Negotiations and Textiles/Apparel.

Members of Congress who represent textile constituencies are more concerned about the Uruguay Round of GATT than about NAFTA. Phasing out the MFA is bound to be harmful to textiles and apparel; and even if NAFTA does not lead to multiple plant closings and job losses, a new GATT agreement will. The United States has already made significant concessions in the Uruguay Round. These concessions go much further than we support. In general, we would like assurances that we will make no significant additional concessions to reach an agreement in Geneva.

In this connection, we make four specific requests:

First, if you want support for NAFTA from members from textile constituencies, extend the phase-out of the Multifiber Arrangement from ten to 15 years. Fifteen years will give the domestic industry time to adjust to a wave of imports unrestrained by quotas. A number of textile exporting nations, such as the Caribbean countries, also favor a 15-year phaseout. They realize that it will be hard for them to compete in the U.S. market against lower-wage nations like China once trade-allocation by quotas is eliminated.

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Second, the staging of tariff reductions and quota phase-outs should be gradually implemented over the entire phase-out period. For quotas, the United States should not agree to lift restrictions on "sensitive products" until the last possible stage, preferably the last year or two of the phase-out. "Sensitive products" are those whose import penetration levels already exceed 20% of domestic production. Moreover, tariff reductions should be imposed gradually and equally over the entire period and not "front-loaded" in the first few years.

Third, the United States should not take any further steps to reduce tariffs beyond those recently reported to the domestic industry. We understand that U.S. and European industry recently discussed the tariff issue and concluded that their differences are narrow. They are convinced that U.S. and European negotiators can arrive at an agreement acceptable to both sides. Our government should make no offer beyond the levels European and American industry have discussed.

Fourth, any tariff reductions and quota phase-out should be directly linked to market-opening by textile exporting nations. For those nations that keep their markets closed to our textile and apparel goods, quota growth and tariff levels should be frozen. In determining whether a foreign market is open, we should require that the exporting nation has eliminated both tariff and non-tariff barriers. For tariffs, the effective level of market opening means harmonization at maximum bound levels of 7.5% for fibers, 10% for yarns, 24%-26% for fabrics and made-up products, and 35% for apparel. While it is difficult to measure the removal of non-tariff barriers, it is not impossible. One yardstick is to ascertain if a nation's textile and apparel imports are less than 15% of its exports. If imports are below 15%, it is generally safe to conclude that its market is not open. GATT has always assumed that market access opening on our part is linked to market access on the part of exporting countries. The cover note (C) to the December 20, 1991 draft agreement states:

Final agreement on the attached draft final act will depend on substantial and meaningful results for all parties being achieved in the ongoing market access negotiations; this applies to areas such as...textiles and clothing.

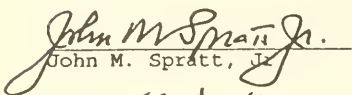
These are not new or unexplored proposals. They have been discussed for months with the Commerce Department, the USTR, the Customs Service, the Labor Department, and the Treasury. The

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Committee for the Implementation of Textile Agreements (CITA) has been working on stronger rules to police transshipment since last spring, and what we propose is only a small part of what CITA has under consideration.

Commitments from your Administration on these issues of importance to the textile/apparel industry would help decide our vote on NAFTA and could influence the vote of other Members with textile and apparel constituencies. Copies of this letter are going to cabinet members with jurisdiction in these matters. We look forward to your response.

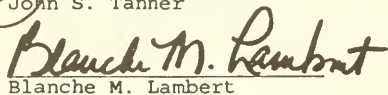
Respectfully,

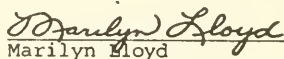

John M. Spratt, Jr.


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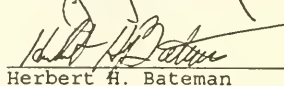

Howard Coble

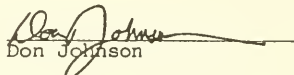

John S. Tanner


Blanche M. Lambert


Marilyn Lloyd


J. Roy Rowland


Herbert H. Bateman


Don Johnson


Nathan Deal

cc: The Honorable Lloyd Bentsen
Secretary of the Treasury

The Honorable Ronald H. Brown
Secretary of Commerce

The Honorable Robert B. Reich
Secretary of Labor

The Honorable Michael Kantor
United States Trade Representative

The Honorable George J. Weise
Commissioner of Customs

THE WHITE HOUSE

WASHINGTON

November 16, 1993

Dear John:

Thank you for your letter of November 10 concerning the Uruguay Round, NAFTA and questions concerning Customs Service enforcement of trade agreements affecting textiles and apparel. While I appreciate your concerns, I believe NAFTA will be a strong, positive opportunity for the textile and apparel industries and workers of the United States.

Let me respond to each of the points you have raised. First, regarding the enforcement of NAFTA, we believe the Customs Service procedures set out in the agreement are one of its strongest features, and a major improvement over the provisions of the U.S. - Canada Free Trade Agreement. I can assure you that I am committed to effective enforcement of NAFTA, and I am happy to work with your specific suggestions in order to ensure that you and other members are satisfied that the agreement will be properly implemented.

In response to your request regarding Customs Service funding, I can assure you that we will dedicate an additional \$15 million supplement to the enforcement of textile and apparel regulations and rules, as well as related competitiveness trade matters. A substantial majority of these funds will be used for an increased number of audits, criminal investigations, identification of high risk shipments and "Jump Team" activities. Out of these added funds, Customs will provide for an additional 50 import specialists, agents, and inspectors to work exclusively, to the extent practical under the circumstances, on textile/apparel enforcement other than NAFTA. I will ensure that the Customs' commercial program associated with both the enforcement of NAFTA and other textile and apparel enforcement will be held harmless from our government-wide effort to reduce employment levels.

With respect to NAFTA enforcement efforts, I can pledge to you that the Customs Service will hire 136 new employees, fifty of whom will be dedicated to enforcing textile and apparel rules and regulations. Many of these new employees will be stationed along the Southwest border to handle the increased activity produced by NAFTA. Others will be placed where they can best be used to enhance our trade enforcement efforts.

Assuming NAFTA is passed, Secretary Bentsen assures me that we will have at least 50 new auditors, 41 import specialists, 25 additional agents, 10 new analysts and 10 new inspectors. These

personnel are being recruited to improve our ability to ensure that our Customs rules, including particularly the rules of origin for textiles and apparel, are enforced.

The other suggestions you have made are within the administrative authority of the Customs Service, and I am pleased to consider implementation of your suggestions, with some minor modifications, as a way to ensure the integrity of the NAFTA agreement. The Customs Service will commit to issuing by April 1, 1994 proposed regulations on your suggestions for extension of the redelivery period, changes to the mitigation guidelines and issuance of certificates of origin/textile declarations on non-NAFTA qualifying shipments. Naturally, these proposed regulations would have to be subject to the normal administrative and legal procedures for issuing proposed regulations. But you should know that I am less certain of the merits of the suggestion for submission of these certificates "well in advance" of the goods arrival. This proposal must be reviewed with an awareness of possible burdens on the importing community.

Also Customs would be prepared to establish through a directive the necessary procedures for all U.S. Customs Districts, as well as foreign offices, to provide a monthly report to the Commissioner on all textile transshipment cases under investigation; and all results from Jump Team reports; seizures and shipments denied entry including the quantity and value of such shipments; and any indictments or fines and penalties with all appropriate details concerning the violation. As you are aware, U.S. Customs and the Committee for the Implementation of Textile Agreements (CITA) have recently signed a Memorandum of Understanding (MOU) detailing the types of information that will be provided in transshipment cases. U.S. Customs is committed to providing as much information as possible through this new procedure.

As to the Uruguay Round, I appreciate the difficulties faced by the textile and apparel sector in that negotiation. I am quite aware of the difficulty in asking the textile and apparel industries to agree to the phased elimination of the quota system and substantial tariff cuts simultaneously.

First, you mentioned the transition period for the phase out of the Multifiber Arrangement and the implications for many nations, given the dominance of countries such as China in the marketplace. Let me note that we have pursued a very aggressive posture toward China in our bilateral textile discussions with them, due to the difficulties we are having with transshipment and overshipments from China. In addition, China would not be afforded the increased growth in its quotas provided for in the draft Uruguay Round agreement unless and until it becomes a full member of the General Agreement on Tariffs and Trade and agrees to open its markets to U.S. textiles and apparel.

With respect to the duration of the phase-out period, I can

pledge to you that we will do all we can to achieve the longest possible phase-out period. I will ask Ambassador Kantor to explore the prospect of a 15-year phase out with those nations that you believe favor it, such as the ASEAN and Caribbean nations and Ireland. If we find sufficient support among these nations for a 15-year phase-out period, we will put on the table, with their support, a proposal for a 15-year phase out, and will seek to negotiate acceptance of such a proposal. Failing that, we will work for acceptance of the longest-possible phase-out period that we believe can be achieved.

Second, we intend to work closely with the affected industry groups to ensure that the impact of the Uruguay Round is eased to the maximum extent possible, including specifically addressing the question of gradual and even staging of tariff reductions and quota integration. With respect to tariffs, this Administration has made it clear that the tariff cuts for textiles and apparel must be phased in over a longer period than many of the other tariff cuts in this Round and we have insisted that the tariff cuts should be staged over a period at least as long as the phase out of the MFA. As I mentioned, I do recognize and appreciate that the U.S. textile and apparel sector has been asked to make substantial concessions in the Uruguay Round, and I am sympathetic to this request.

With respect to the integration of textiles and apparel into the GATT, we do not intend to integrate sensitive products until the end of the phase-out period. We will examine very carefully the sensitivity of products in our market, and we will work with the industry and interested members of Congress to determine which products should be left for integration at the end of the phase-out period.

Third, I am informed that the U.S. and EC industries have tried to put aside their differences on the subject of wool tariffs, and to work to find common ground and I do commend the industries for their leadership. While the EC Commission has not accepted at this point that the industry's discussions on the tariff issue merits their agreement, I would note that these discussions are still ongoing. If the industry's efforts are ultimately successful, we will work with the U.S. interests to ease to the extent possible the impact of any agreed-upon tariff cuts and would not anticipate going substantially beyond our current proposals on sensitive products.

Finally, we fully agree that effective market access commitments must be made by countries participating in the Round, both to reciprocate for our agreement to the phased elimination of the Multifiber Arrangement and to fulfill the commitment entered into at the outset of the Round that all participants would bring all measures under the discipline of the GATT. We are working diligently in bilateral market access negotiations to attain this goal, and have specifically proposed that tariffs be lowered and bound to levels no higher than 7.5 percent for man-made fibers, 15 percent for yarns, 30



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percent for fabrics and made-up products and 35 percent for apparel in order to demonstrate that market access has been provided. We have insisted, and will continue to insist, that our willingness to phase-out the MFA be linked directly to the achievement of effective market access in individual countries by removal of non-tariff barriers and lowering of tariffs. I should also note that we are evaluating the options available to us should some countries fail to meet this obligation. In this connection, we are working closely with the industries concerned, and would of course welcome your input.

Thank you again for your ongoing interest and assistance on trade issues.

Sincerely,

The Honorable John M. Spratt, Jr.
House of Representatives
Washington, D.C. 20515





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